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2004

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### **citation for published version (APA)**

Filipovic, N. (2004). *Strategic Change Management of Medium-Size Companies: Insights from Slovenia and Croatia*. [PhD-Thesis – Research external, graduation internal, Vrije Universiteit Amsterdam].

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VRIJE UNIVERSITEIT

Strategic Change Management of Medium-Size Companies:  
Insights from Slovenia and Croatia

ACADEMISCH PROEFSCHRIFT

ter verkrijging van de graad van doctor aan  
de Vrije Universiteit Amsterdam,  
op gezag van de rector magnificus  
prof.dr. T. Sminia,  
in het openbaar te verdedigen  
ten overstaan van de promotiecommissie  
van de faculteit der Economische Wetenschappen en Bedrijfskunde  
op donderdag 4 november 2004 om 13.45 uur  
in het auditorium van de universiteit,  
De Boelelaan 1105

door

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*“While most people understand first-order effects, few deal with second- and third-order effects. Unfortunately, virtually everything interesting in business lies in fourth-order effects and beyond”*

Jay Forrester

## 1. Introduction

My strong interest in the phenomenon of strategic change has its roots in the early days of my professional career. After obtaining an advanced degree in computer sciences I left university and joined an international corporation headquartered in Croatia. I became responsible for a major R&D project in the area of computerized control systems, which eventually generated an extremely successful product line and led to my fast elevation through the management ranks.

From the very first days of my managerial career I knew that, although it was to a large degree intertwined in the “socialist” economy of former Yugoslavia, due to its presence in the international market the corporation I worked for had to offer competitive products or services in order to sustain its success. My team managed to turn a division with “me-too” products and mediocre performance into a highly energized, ambitious and ultimately successful international player. However, the business environment in former Yugoslavia<sup>1</sup> started to deteriorate significantly in the mid-1980s, and the corporation faced huge challenges. While we were successful in bringing our division to measurable success in international markets in the early 1980s (e.g., we were the number one company worldwide on the World Bank tenders for certain types of energy control systems in 1986 and 1987), my colleagues and myself were less successful in maintaining that position, both for the division and the corporation as a whole. When in 1989 I became Senior Vice-President and a member of the Executive Board of the corporation I witnessed its dive in performance. Despite all our transformation efforts, the corporation was forced, several months after I left it for the world of academia at the beginning of 1991, to enter technical bankruptcy.

In the past decade I had an outstanding opportunity to closely witness (in several cases as an active participant) a number of initiatives in Central and Eastern Europe. Few of these were government-led, aiming at changes in the macro-economic frame; the vast majority were played out on the corporate level, some profoundly successful in turning the fortune of a company around, others generating little more than prolonged pain and misery. Through my activities as faculty member of the leading business school in the region and as consultant to a number of general managers<sup>2</sup> I had a true “living laboratory” where I could study, interpret

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<sup>1</sup> I am using the phrase “former Yugoslavia” to refer to the “Socialist Federative Republic of Yugoslavia”, which existed under different names in one area of South-East Europe from 1945 to 1991, after which it ceased to exist in its prior form after the formal declarations of independence on the part of Slovenia and Croatia (and later Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia).

<sup>2</sup> The management terminology in the region recognizes no universal term for the person formally in charge of a company. The reasons for this are simple: the legal framework defining corporate governance is a recent creation and differs from country to country. Words such as “general manager”, “president of the management board”, “CEO”, “director” etc. are often used arbitrarily and, to avoid misinterpretation, reference to the local legal situation should accompany the term. Throughout the text I shall use the term “General Manager” to designate the person with legal responsibility for day-to-day operation of the company (even though a somewhat more appropriate title in Croatia and Slovenia would be “President of the Management Board”). To avoid confusion I



and help manage strategic change processes at first hand. These activities stimulated my curiosity further and led to a more focused interest in change processes, eventually resulting in field research and the empirical data used in this thesis.

## 1.1 Problem definition

Central Europe as a whole, and particularly the companies operating in the region, have undergone a major process of transformation. On the one hand, this process has been unique, influenced by specific historical conditions and local cultures, a specific economic and social context, and the particular intensity of change. On the other hand, it may also offer conclusions interesting for other regions in transition and for a better understanding of the process of corporate transformation as such. While I witnessed the process in the whole of Central Europe, I shall focus my research in the next chapters on Croatia and Slovenia. This is not because I believe that the transformation in these two countries fully represents processes in others, but because I had much better access to the empirical base in these two countries, granting the necessary robustness to my research. For this reason I do not claim that the results of this research apply to the whole region beyond the level of general applicability to corporate transition processes.

While Central Europe may be used as a geographical term, a more common political definition usually follows the lines of divisions created after World War II and leaves Bavaria, Austria and Switzerland outside the region. Even if one accepts the narrower definition to include Poland, the Czech Republic, Slovakia, Hungary and Slovenia (leaving as an open question the precise borders between Central and Southeast Europe and the affiliation of countries such as Croatia or Romania), the region's economic outlook is complex and often subject to highly divergent qualifications. In my work I defined "emerging market economies" as those economies featuring two things: a rapid pace of economic development, and government policies favoring economic liberalization [Arnold and Quelch 1998]. By that definition the region as a whole can be classified among "emergent market economies", or "economies in transition" [Hoskisson et al. 2000], the phrase most often used in the region itself and by the politicians and institutions involved there (such as the European Bank for Reconstruction and Development [EBRD 2002]). These terms, however, say little about the specifics of individual countries, and even less about the different profiles of the companies thriving and failing there.

As the name "economies in transition" implies, a common characteristic of companies in the region is the process of transformation they entered when the political and economic system began to change. While exact dates differ from country to country, for most transition commenced roughly between 1989 and 1991. The degree of change in the environment was huge, and generated a need for discontinuous change on the company level [Ansoff 1988]. Some companies did anticipate initial changes, but the previous political and economic environment left limited room for pre-emptive adaptation. The majority reacted by following one of several patterns of transformation. The first period of change featured the transformation of political systems from single-party authoritarian regimes to multi-party parliamentary democracies. At the same time, economies (most, with the exception of former Yugoslavia, which had a mixed economy comprising a relatively free goods market but state-interventionist labor and virtually non-existent capital markets) were converted from centrally

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shall use the term "Board Chairperson" to designate the person with legal responsibility for long-term governance of the company (in Croatia and Slovenia, given a two-tier board system, the appropriate title would be "Chairperson of the Supervisory Board") [Filipović *et al.*, 2001]

planned into free-market systems. This transformation coincided with the collapse of regional markets, producing a significant loss of revenues for virtually every business in the region. Thus the key challenge for companies was survival, which – because of the sudden drop in revenues – required rapid streamlining, i.e. a focus on core products and services, reduction of excessive costs, and downsizing to match reduced market opportunities<sup>3</sup>.

Although the period of initial transformation on the company level in most cases lasted from two to five years, it typically did not end with stability. New changes in the environment followed, this time characterized by the opening of markets and increased local and foreign competition. Companies in the region were challenged to further improve their competitiveness, or perish. Many found that a focus on cost, rather than value-added position, was unsustainable. In many cases a local market focus proved to be similarly non-viable and had to be replaced with an orientation towards regional or even global markets. This transformation phase has proved even longer than the first, and the majority of companies in the region are still in this second phase<sup>4</sup>. It is highly likely that even in the most developed countries in the region, such as Slovenia, this stage of transformation will last at least another decade, and companies from less developed countries may need several decades to catch up with their western counterparts. Better understanding of the transformation process may therefore be highly beneficial for managers in the region, making this research even more relevant.

In order to adapt, companies had to go through a sequence of transformations, each requiring a strategic change management process [Kozminski 1993]. While both academic and popular management literature deal extensively with the underlying issues of competitiveness and strategic change management, a significant portion of it is not, for several reasons, easily applicable or even relevant when clarifying the varied performance of companies from Croatia and Slovenia (Table 1.1).

When looking at the body of research carried out in the fields of competitiveness and strategic change management, one cannot but observe a bias towards large North American companies. Some research published in the leading academic journals was performed in emerging markets<sup>5</sup>; significantly less dealt with Central Europe; and even less focused on companies originating from that area (the effects of privatization being the major research interest [Uhlenbruck and De Castro 2000]). Within the region, Croatia and Slovenia attracted minimal attention on the part of external researchers in comparison with countries such as Poland, Hungary and the Czech Republic. Some research was done locally and published in domestic and international journals, but it mostly took an economic perspective [Milanovic 1999, Alexeev 1999, Halpern and Korosi 2001] and was rarely dealt with the area of competitiveness as seen from the company perspective [Prašnikar et al. 2000], or with strategic change management in a specific regional context [Bojnec 1999, Newman 2000, Kets de Vries 2000, Filatotchev et al. 2000]. Furthermore, Newman [2000] argued that no theory of intraorganizational change could deal explicitly with an external environment that is so chaotic.

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<sup>3</sup> In the literature on organizational transformation this is often referred to as “defensive restructuring”.

<sup>4</sup> In the literature this is often referred to as “strategic restructuring”.

<sup>5</sup> See *Academy of Management Journal* [43(3) 2000] as a good example with a fairly representative sample of theoretical approaches, subjects and geographical coverage.

| Level        | State-of-the-art literature<br>(Western focus)                                                                                                                   | Requirements of Slovenian<br>and Croatian companies                                                                                                                                   |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Environment  | <ul style="list-style-type: none"> <li>• Dynamic markets within relatively stable socio-political environment</li> <li>• Stable capitalist structures</li> </ul> | <ul style="list-style-type: none"> <li>• Discontinuous change in all components of the environment</li> <li>• New questions of purpose, business model, form of control</li> </ul>    |
| Organization | <ul style="list-style-type: none"> <li>• Large multinational companies with autonomous business units</li> <li>• Relative abundance of resources</li> </ul>      | <ul style="list-style-type: none"> <li>• Medium-size niche players with functional structure</li> <li>• Shortage of most resources</li> </ul>                                         |
| Individual   | <ul style="list-style-type: none"> <li>• Well educated managers</li> <li>• Stable career paths and expectations</li> </ul>                                       | <ul style="list-style-type: none"> <li>• Management as a completely new profession, old mindset and lack of skills</li> <li>• Pressures encouraging opportunistic behavior</li> </ul> |

Table 1.1 Key differences between western and local focus

In terms of company size, standard research deals with both ends of the scale: the majority of research samples are from multinational companies (MNCs)<sup>6</sup>, but a certain portion covers small and medium-size companies (SMEs). The latter, however, are in most cases new ventures and entrepreneurial “gazelles” (i.e. fast-growing small businesses). I find it interesting to focus research on companies which do not reach the size of the global players in their industries. These companies, in relative terms medium-size<sup>7</sup>, dominate the corporate scene in Croatia and Slovenia (and, as a matter of fact, other countries of Central Europe) and are integral to the economy in other geographical areas, such as Benelux.

I find the argument of size (and structure, which is in most cases the consequence of size) to be relevant to the theoretical discussion, since much theory and analysis important on the MNC level (e.g. strategic portfolio analysis, cross-divisional synergies based on core competence, globalization, institutional influence of size on the change process) are often neither applicable nor useful with regard to medium-size companies (which are typically functionally organized niche players, or cost players in regional markets, and have a relatively small number of managers). Also, the resources available to middle-size companies for

<sup>6</sup> Throughout the text I shall use the abbreviation MNCs for multinational companies. I am using the term as reference to companies having operational subsidiaries in countries outside of the region holding their headquarters (typically having global presence).

<sup>7</sup> Throughout the text I shall use the abbreviation SMEs for small and medium-size companies. Note that most countries explicitly define the size of small and medium companies, typically for accounting, tax and/or governance purposes. However, definitions vary both in terms of the measurements used (typically the number of employees, but some countries, like Slovenia, also use alternative yardsticks such as total revenues) and numbers (definitions of the lower limit of employee numbers for medium-size companies are typically in the range of 50 to 500). In this thesis I use the term medium-size (or middle-size) company somewhat differently: I do not refer to a strict legal definition of size, but rather to companies *which have several hundred or up to a few thousand employees, typically have one major operational division and, while possibly present internationally, are not MNCs.*

enhancing their capabilities are significantly more limited than those of MNCs, and the level of inherent flexibility is significantly lower than among entrepreneurial ventures, both implying that routes to competitiveness may differ according to company size [Chen and Hambrick 1995, Stock et al. 1996]. Finally, the process of strategic change management is also influenced significantly by the size of the company [Hannan and Freeman 1984, Singh 1990, Haveman 1993, Chen and Hambrick 1995, Harari 1998].

The other reason why I could not assume that research carried out outside the region is fully relevant to the transformation process of companies there is these companies' specific cultural background. Corporate culture has been identified as one of the key elements of inimitability contributing to competitive advantage [Barney 1986, Fiol 1991], as well as being a major issue in strategic change management [Schein 1985, Vollman 1996, Breu 2001]. And corporate culture has been clearly linked to the cultural context [Hofstede 1980, Schein 1985, Breu 2001], which is in Central Europe both rich and highly specific.

Given the specific context of transition in Croatia and Slovenia outlined above and described in more detail in Chapter 2, it is compelling to commence a thorough examination of the regional applicability of general theories related to competitiveness and strategic change management, and to develop a suitable theoretical model which will endure empirical tests.

Finally, as well as questioning the regional applicability of state-of-the-art literature on competitiveness and strategic change management, I have observed another major shortcoming worth discussion. Most of the existing literature focuses on only one of the three aspects which, I believe, are crucial to explaining differences in the success rate of transformation efforts in the region: *context*, *content* and *process* [Pettigrew 1987]. Only rarely does research focus on the multidimensional aspects of all three. I believe that keeping all these dimensions in perspective is mandatory for understanding the results of transformation, and I shall accordingly devote sufficient space in my thesis to cover them.

## 1.2 Objectives of the thesis

The main objective of this thesis is to develop an integrative analytical framework based on state-of-the-art literature in the areas of competitiveness and strategic change management, adapted to the specific requirements of Slovenia and Croatia, in order to explain the observed transformation processes and support companies in their further transformational efforts.

In terms of the political, economic and social context (which Pettigrew [1987] called the "outer" context), I shall try to clearly identify and detail the specific context of countries in transition, in particular Croatia and Slovenia. I will present this context holistically in Chapter 2, and will also refer to it in the critical literature review in Chapter 3. The inner context [Pettigrew 1987] will be defined company-by-company in case descriptions in Chapter 5.

Regarding transformational efforts which companies have undertaken (referred to in the following chapter as "strategic change management content"), I shall refer to the wide body of theory on the concept of competitiveness. I justify this quite simply: improving competitiveness is of key concern throughout the region and is the explicit goal of almost all transformation efforts. The increased globalization of business coincided with the opening up of the business environment in Central Europe as a whole and in Croatia and Slovenia in particular. Opening up occurred in two directions: outside-in and inside-out. All the countries in the region are candidates for European Union membership, some immediate (2004) and others in the next wave, which means that all have had to drastically alter both institutional

frameworks and current practices, which in turn has lowered barriers to foreign companies wishing to enter local markets. In addition, political and economic risks in the region have been significantly reduced and governmental efforts to attract FDI have in general increased, attracting foreign companies [Kozminski and Yip, 2000]. On the other hand, companies from the region are increasingly doing business outside it, either because they have found truly better business opportunities or because this is a desperate attempt to solve problems unsolvable in local markets. In order to survive in open markets, companies from the region must achieve an appropriate level of competitiveness. This is widely recognized by management and researchers, and is the prime motive for recent transformation efforts<sup>8</sup>.

In looking at competitiveness, I shall examine a few theoretical frameworks that have in recent years occupied the research community, in particular the resource-based view of the firm, which has in the last decade established itself as the most influential theoretical framework for understanding how companies achieve and sustain competitive advantage [Wernerfelt 1984, Barney 1991]; also the dynamic capabilities approach [Prahalad and Hamel 1990, Eisenhardt and Martin 2000].

Concerning the ways transformation has been implemented (I refer to this in the following chapter as the “strategic change management process”), I shall look at key aspects of strategic change management, including some distinct management tools and concepts as re-engineering, organizational learning, organizational transformation, and leadership.

Based on the literature review I shall construct the research model, setting out an expected pattern of behavior according to the influence of context, current transformation content and process, and how these influence the outcomes of strategic change. Then I shall compare it with the empirical findings and, where necessary, adjust it.

My ultimate goal within this thesis is thus to identify a number of factors:

- those which are internal by nature (often called “organizational”), i.e. dependent on the company and potentially directly or indirectly influenced by its management (as opposed to external factors, which depend primarily on the socio-political or industrial environment and are not under the direct or reasonable indirect decisive, systematic and sustainable influence of the management of any single company), and
- those which explain the process of strategic change and the difference in outcomes of various strategic change efforts, which in successful cases eventually lead to improved company performance compared to the past and to the performance of local competitors.

In the methodological approach providing the empirical basis of the thesis, I agree that intangible resources as source of competitiveness should be diagnosed via qualitative methods [Zahra and Pearce 1990, Rouse and Daellenbach 1999]. This approach is in line with that of established studies of organizational cultures and change phenomena [Pettigrew 1990], and accordingly both dimensions of my research are processed in a methodologically uniform way. To this end I have built the empirical base on an in-depth analysis of case studies from Slovenian and Croatian companies. Although I am aware of potential shortcomings (presented in Chapter 4), I shall attempt to generalize my findings into a simple conceptual framework.

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<sup>8</sup> In a recent survey 82% of managers indicated that their companies face the need for change. The survey indicated that their number one priority was to develop a business strategy to achieve competitive advantage (on the scale from 1 – least important to 5 – most important, this goal went up from 2.90 for the period of previous 5 years to 4.89 for the period of next 5 years) [Filipović and Gudić 1999]

## **1.3 Structure of the thesis and short overview of chapters**

### **1.3.1 Methodological structure**

In order to help the reader find the way through the methodologically fairly complex study the key concepts and their location in the text are explained below.

The conclusions offered in the reference literature and, in particular, the application of my resource-based view of the situations in Slovenia and Croatia (chapter 3.2.2) prompted me to focus on the concepts of perceived urgency and perceived feasibility of change as determinants of strategic choices made by top management. In other words, my conclusion is that the managers decide whether to initiate any changes at all or not, as well as what kind of changes they would like to achieve, on the basis of their views of how urgent it is for the company to improve its competitive performance, as well as what they thought is the likelihood of a successful outcome of the attempted changes.

The study of literature related to the process of change management indicated that a three-phase model is the most appropriate to describe change. Thus, the concept of a trigger phase, a design phase and an implementation phase is introduced in 3.4.2 (Fig. 3.11).

Top management proceeds from the trigger phase to the design phase only if and when convinced that the change is needed and feasible (3.4.2.1, Fig. 3.12).

The research model developed in 3.4.2.2 predicts that managers design the changes based on the perceived urgency and feasibility of change, and that the design includes strategy, organizational structure and systems. Three main design outcomes are defined based on the literature review: defensive restructuring, strategic restructuring and non-aligned changes (Fig. 3.13).

Based on the literature review, the research model predicts some specifics of the strategy, the structure and the systems, as well as the required key resources, leadership interventions and barriers to change become obvious in the implementation phase of a defensive (3.4.2.3) and a strategic restructuring (3.4.2.4).

Based on the assumptions derived from the research model and observations from field research, a methodology is developed linking the indicators of perceived urgency and perceived feasibility to the outcome of the design phase. Aggregate weighted indicators of perceived urgency and perceived feasibility are converted into pairs of points and presented in a diagram, in which different areas are associated with different outcomes of the design phase: no change, non-aligned changes, defensive restructuring or strategic restructuring (chapter 4.3).

Questions arising from the research model (3.4.3) led to a field study comprising a set of detailed case studies of seven companies carried out over a period of thirteen years (Chapter 5). Up to four different change cycles are identified in each of the cases. The field research focused on identifying indicators of urgency and feasibility for each change cycle in each of the companies (6.2.2 and 6.2.3), which were then fed into the calculation model presented in 4.3. The results are shown in diagrams (6.3) that describe the nature of individual change cycles for each of the companies. Finally, details of observed characteristics of defensive restructuring change cycles (6.4) and strategic restructuring change cycles (6.5) are compiled and their consequences for the research model established.

### 1.3.2 Short overview of chapters

Chapter 2 presents a rough synopsis of the change occurring in former Yugoslavia between 1981 and 1991, as well as during the period on which research is focused (1991 to 2003). It provides the reader with a better understanding of the context of change: the political, social and economic environment in which the observed companies were operating. In many ways this environment was unique, while at the same time it shared many features with other environments exposed to large-scale change, especially in countries in transition. Thus, while strong reference to the context has been maintained throughout the text, similarities have been pointed out as useful starting points for possible generalizations.

Based on the key challenges for management identified in Chapter 2 the text develops into an overview of relevant literature on competitiveness and strategic change management, presented in the first two sections of Chapter 3. Since both concepts are widely covered in academic and popular literature, I first identify the principal “schools of thought”, which have dominated the literature in recent years and can potentially be applied to the context I am exploring. I then narrow my focus to key, universally-accepted common conclusions and major controversies which are a matter of contemporary debate. Throughout this literature analysis I highlight the applicability of the concepts presented to the context of countries in transition. In the final part of Chapter 3 I present the research model, which brings together the content of strategic change focusing on competitiveness improvement, and the process of change management, both adapted to the context described in the Chapter 2.

Chapter 4 provides a brief overview of the research methodology used in the study. It outlines in more detail the rationale behind the chosen research strategy, and discusses the merits and limitations of case-based research. It also lays down the criteria for case selection; it presents the basis for an analytical approach to the cases, as well as the methodology used in supplementary interviews and accessing secondary data sources. In the final section of Chapter 4 I present the methodology used to calculate the point values in “perceived urgency of change – perceived feasibility of change” diagrams.

Chapter 5 presents a detailed analysis of the empirical data from seven cases, compiled from different sources: annual reports, media archives, consulting reports, teaching cases, structured interview with executives and middle managers, and feedback on preliminary conclusions from independent experts and company representatives. As well as these cases, summaries of research findings from individual cases are presented.

Chapter 6 is dedicated to a cross-case analysis. It explicitly answers the research questions, and demonstrates how the empirical data conform to the research model expectations based on the literature review, also indicating where there were critical mismatches between expectations and empirical findings. The final section provides a refined version of the research model.

In Chapter 7, finally, I summarize my conclusions, with particular emphasis on new insights arising from the specific research context and their potential for general applicability. Although the research was not conducted with the objective of generating prescriptive conclusions, in my summary of the project’s implications I also outline implications for management practitioners.

## **2. Characteristics of change processes on the macro level in Croatia and Slovenia in the period from 1981 to 2002**

In order to understand the strategic change processes at the level of any individual company, it is necessary to understand both the external setting and the internal forces influencing the change. Both of these dimensions allow for some context generalization, while leaving room for case-by-case analysis of individual companies (to be presented in Chapter 5). In the present chapter focus is placed on the political, social and economic environment of Croatia and Slovenia, which has had a significant influence on the change process at the enterprise level. As well as illustrating the key manifestations of change, this chapter explores its challenges for management and thus sets out more clearly the research questions in anticipation of a literature review and the construction of a research model. Given the need for brevity, some of the descriptions and analyses presented have been simplified.

### **2.1 Choice of the relevant geography**

As stated in Chapter 1, some countries with “emerging market economies” share a similar historical context of political and economic change. Some to large degree also share key elements of the cultural context. This is especially true for the Central European countries as defined in 1.1. In order to maintain context validity for my research, I have narrowed the choice of relevant geography for the ethnographic research described in this thesis to only two countries: Croatia and Slovenia. However, since some of the companies observed carry out significant activities throughout the region<sup>9</sup>, I shall in this chapter both lay down a potential basis for generalization of my conclusions, and examine comparatively not only Croatia and Slovenia but also key attributes of the situation in other Central European countries.

I have decided to select Croatia and Slovenia as target countries for two principle reasons. On the one hand, most of the companies I have been involved with in my professional activities come from the region or are local or regional subsidiaries of MNCs. Of that sample, the majority are headquartered in Croatia or Slovenia. Thus, in these countries I have been able to reach a certain level of understanding of the context, as well as the level of intimacy with individual companies required for ethnographic research.

In addition, the two countries present an interesting choice because of their similarities and differences. Both spent several centuries as part of the Austro-Hungarian Empire, and almost a century as republics within former Yugoslavia and its predecessor the Kingdom of Yugoslavia. At the moment of declaring independence from former Yugoslavia they were at similar levels of economic and political development (see 2.2). A shared history, together with geographic proximity and the same linguistic and cultural roots within the Slavic group of nations, implies significant similarities in social and cultural context. Yet, due to a number of factors, from 1991 onwards the two countries developed in strikingly different ways, their divergence to a large extent reflecting the spectrum of development paths emerging in the rest of Central and Eastern Europe. Thus they represent a “universe in small” for the whole region, and the situations in their respective companies serve as a potential basis for generalization of strategic change theories.

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<sup>9</sup> This is especially true for companies in consumer industries, as opposed to those present in industrial markets, which are focusing more on EU countries, as discussed in Chapter 5.



## **2.2 Political and economic point of departure (1981-1991)**

In order to better understand the process of economic restructuring that began throughout the region in the period from 1989 to 1991 it might be useful to present a short overview of the situation in the late 1980s, both in political and economic terms.

Once again, one should be cautioned against regarding Central Europe as one homogeneous territory. The differences at the point of departure were obvious on different levels. The region at that time comprised former Yugoslavia and “Soviet block” (COMECON) countries<sup>10</sup>. The differences between the two groups were huge, but the differences within each were not insignificant either.

In comparison with former Yugoslavia, the COMECON countries entered the period of political changes with a significantly higher level of political and economic rigidity. The communist regimes in most of these countries had resorted to harsh autocratic oppression to keep themselves in power. The vast majority of business entities were state-owned, and economies were centrally planned not just at the individual country level but within the whole group. Companies from outside the area had no direct access to regional markets, and were forced to employ indirect mechanisms such as bartering agreements signed between countries.

Former Yugoslavia was in many ways a unique country. The basic elements of its political and economic frame were defined in the Constitution Act of 1974. The hugely charismatic Josip Broz Tito was its undisputed autocratic leader until his death in 1981. He left a legacy of a failing economic system and a complex mechanism of governance based on consensus among the six republics and two autonomous provinces constituting the highly decentralized country. Former Yugoslavia was characterized by the political monopoly of the communist party (which, in order to soften its image and differentiate itself from the Soviet model of communism, presented itself as a Communist League, rather than a party). However, the economic system was unique, departing significantly from the planned economies of the Soviet type.

The key element differentiating the economic system of former Yugoslavia from the rest of the world was the concept of “social ownership”. Social ownership meant that the ownership titles to standard business entities (companies) did not reside with private owners or the state, but was made abstract and given to the employees. In theory this meant that the employees possessed almost all of the ownership rights, such as the authority to appoint the general manager, approve major strategic moves including mergers, or to determine the use of profits. The decision-making system used by the employees was called “self-management”, with “workers councils” playing a role similar to that of supervisory boards. The only right the employees did not have was to sell (or renounce / transfer in any other way) their ownership. In practice, however, these rights were often curtailed by the influence of the (local) political elite, especially in connection with the politically-sponsored management.

Since the concept of social ownership did not allow share capital, there were no capital markets in the traditional sense of the word, but only financial markets with very rudimentary services, operated by parastatal banks. The banking system was the major instrument of state

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<sup>10</sup> For easier reference, as well as for formally correct annotation, Soviet block countries in Central Europe (Poland, Czechoslovakia and Hungary) will be referred to as COMECON countries, after the formal economic cooperation treaty (Council for Mutual Economic Assistance) they signed with the purpose of coordinated planning and state controlled counter-trade and resulting financial settling.

(political) intervention in the economy, since the banks extended soft loans (sometimes with negative real interest rates) or other forms of direct cash infusions into selected companies without any credit risk control. The only capital transactions with companies were mergers. The workers councils of two companies had the right to merge their companies into a new legal entity, with one workers council and one management team overseeing the pooled assets.

Another peculiarity was the relationship between divisions and the mother company in a corporation. In accordance with the idea of worker ownership, divisions acted as owners of the mother company, which created enormous problems in establishing the hierarchical authority of mother-company over divisional management.

Although private ownership of companies was not illegal, the law significantly restricted the size of private companies (until the late 1980s to less than ten employees; only subsequently was the restriction lifted). Also, private companies were often scrutinized by tax authorities and the police. As a consequence, the ambition of private owners was typically limited, while the few notable exceptions had to snuggle up to the political elite or bribe low-level administrators in order to “bend the rules” or relax supervision.

In comparison to the capital markets, labor markets were somewhat more developed, although still not fully liberal. All companies were unionized and the state union was under communist patronage and part of the political system. Firing an employee was extremely difficult, although not impossible. Firings because of breach of discipline had to be procedurally correct, since court rulings were strongly biased in favor of employees, but were relatively common. The standards of work discipline and ethics were quite uneven; in general, they were significantly lower than in western companies, but higher than in their COMECON counterparts. However, there were also quite a few companies with high employee commitment levels and little problem with discipline. These companies were often described as “most respected”, and typically had a strong management with a clear business orientation and vision, as well as a superior relationship with their workers councils.

On the other hand, companies had a formal mechanism through which they could resort to downsizing without a formal bankruptcy procedure<sup>11</sup>, i.e. they could declare that due to changed technology or market situation certain employees had become redundant. Although seniority had to be respected within groups of employees with the same job description, the mechanism in principle generated a level of flexibility higher than in countries with a strong union tradition (such as most of Western Europe). However, massive lay-offs due to business crisis or bankruptcies were extremely rare, since they were seen as the sign of political failure and were usually linked with political shake-ups.

Nurturing of the (artificial) image of the “ideal system” was, as in most autocratic systems, an important part of the political agenda. The concept of social ownership meant that economic success on the macro level was measured by high employment levels<sup>12</sup> and a high level of

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<sup>11</sup> The technical term used was “technological surpluses”.

<sup>12</sup> More developed parts of former Yugoslavia had virtually no unemployment. The same was true for most of the COMECON countries. However, after the change of system the estimated level of “inefficient employment” was high. This statement can be illustrated by two pieces of data: on the one hand, lay-offs due to defensive restructuring cut employment by 35% to 60% [Prašnikar et al. 1999], and on the other hand, productivity measured by revenue per employee lay in many industries significantly below international levels. The phenomenon of inefficient employment as an indirect substitute for a social safety network is not restricted to ex-

social benefits such as free education, healthcare, and housing, generous retirement conditions etc. Thus, a high number of employees with a high level of employee benefits was a politically more interesting goal on the corporate level than profitability or other traditional measures of business performance. Since top managers needed clearance for their (re)appointment from their workers council and from the local political elite (in the case of the biggest companies, clearance was usually granted on the level of the domicile republic's political leadership), they were careful to keep their employees loyal and have politically correct goals visible on their agendas. They tended to avoid innovative and risk-taking behavior, nurturing a culture of passing decision-making to higher levels in the hierarchy.

Employee benefits were an extremely important source of motivation. Base salaries were low in comparison with Western Europe, and were among the most important causes of the high level of brain-drain since the mid-1960s, especially among skilled labor, technical experts and scientists<sup>13</sup>. The low ratio between the highest and lowest salaries in the company (typically less than 3:1) was another significant problem, demotivating managers and often driving them towards unethical practices (bribery, private companies taking advantage of the business relationship with the company they were employed in, etc). However, when the total compensation package was taken into consideration and corrected for purchasing parity, the earnings of non-managerial employees were more than comparable to those in many West European countries, although productivity was significantly lower<sup>14</sup>. Although some employee benefits were granted by the state, many were provided by the companies and were related to the financial success of the company. Thus, indirect motivation for superior performance existed and was well understood by the management. It should be noted, however, that financial performance was not necessarily determined in free market competition, but was also generated by skillful creation of monopolies through use of political connections or "system aberrations" (e.g., the obtaining of import protection or political derailing of local competition, securing of favorable sources of raw materials or cheap financing, exploitation of sudden changes in legislation or shortages in product or financial markets as anticipated by political insiders, or by the blunt use of corruption or political power to secure the funds needed). As a consequence, the most successful managers had to develop a specific set of relationship skills and a personal network of relationships which allowed them to lobby for their interests.

In contrast to capital and labor markets, products and services markets were relatively well developed. Although state intervention in these markets (typically in the form of price control as well as import barriers) was higher than would be acceptable in a true market economy, companies were nevertheless exposed to significant competition in local markets. In addition, they were politically encouraged to export and were often able to reap direct and indirect benefits from their export activities. Although official policy promoted economic relations with "third-world"<sup>15</sup> countries (most of which were, in economic terms, emerging market economies), COMECON countries and especially the free-market countries were much more

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communist countries: state bureaucracy in South Korea and some Latin American countries are another perfect example.

<sup>13</sup> The estimate of the number of citizens of former Yugoslavia working abroad, and members of their families, was in 1989 close to 2 million (nearly half of it in Germany), almost 10% of the overall population.

<sup>14</sup> In most industries lower productivity almost cancelled the advantage in direct labor costs, even without taking into account indirect benefits and correction for purchasing parity (e.g. average labor costs in the food industry in Slovenia in 1990 stood at 40% of the EU average, while productivity was at 48% [EMBA Projects 1992]).

<sup>15</sup> The official designation was "non-aligned" countries, following the foreign policy doctrine of President Tito, who was in the early '60s one of the creators and political leaders of the Non-aligned movement, i.e. countries subscribing neither to NATO nor to Warsaw Pact.

important for exports from former Yugoslavia (Table 2.1). Towards the end of the 1980s a clear trend towards growing export to free-market countries was visible, as was a rapidly growing trade deficit<sup>16</sup>, both of these the result of the diminishing importance of trade with COMECON countries and the mounting problems there.

|                       | 1988    |         |                     | 1990    |         |                     |
|-----------------------|---------|---------|---------------------|---------|---------|---------------------|
|                       | Exports | Imports | Exports/<br>Imports | Exports | Imports | Exports/<br>Imports |
| Free market countries | 51%     | 56%     | 87%                 | 59%     | 63%     | 72%                 |
| COMECON countries     | 33%     | 27%     | 118%                | 28%     | 23%     | 93%                 |
| Third world countries | 16%     | 17%     | 89%                 | 13%     | 14%     | 71%                 |

Source: Yugoslav statistical yearbook [1991]

Table 2.1 Structure of foreign trade in former Yugoslavia

This economic model had significant shortcomings [Kovač 1990, Estrin 1991, Prašnikar and Svejnar 1991]. From the system theory perspective, the main problem was the non-existence of economic performance feedback. On the macro level, economic system fine-tuning was possible only within an extremely limited spectrum of ideologically acceptable cosmetics. Also, the political elite made all the key macro-economic decisions, often with very limited understanding of the consequences. On the micro level, under the pressure of “maintaining face” and avoiding social and political tensions, sub-performing companies were kept alive through political intervention, thus fatally compromising overall system performance<sup>17</sup>. Despite its shortcomings, however, the system also had several positive effects when compared to other socialist or communist countries. Since the state only expropriated company profits partially, employees as quasi-owners did receive tangible benefits from superior performance on the part of their companies. In some cases, especially when management was competent in business terms and well connected politically, this led to major advances in competitiveness in local markets, as well as to increased efforts in export. A part of profits was not channeled to employees but was invested in technology, new product development or market development (especially within former Yugoslavia and COMECON countries, where several strong brands were built).

After Tito’s death former Yugoslavia quickly lost its international position. On the one hand, growing political and economic risk made foreign lenders cautious about extending new loans. On the other, the “non-aligned” movement was losing momentum and importance, to some degree because of internal squabbles but more so because of the growing evidence of the weakness of the Soviet Union and its satellites. As a result, the federal government became unable to secure the inflow of foreign loans and FDI, which were needed to keep the failing economy afloat. Two immediate consequences became obvious within a couple of years. Inflation rose to 2000% in the year 1989<sup>18</sup>, while the significant minus in the country’s foreign balance of payments generated in banks a shortage of foreign currency (needed to

<sup>16</sup> The percentage of imports covered by exports fell from 95% in 1988 to 89% in 1989, and to 76.5% in 1990.

<sup>17</sup> At an even lower level of analysis, poor individual performance also went in most cases unpunished due to the high level of employee legal protection, the great influence of workers and unions (through workers councils and political pressures) as well as widespread cynicism about work ethics, well-depicted in the slogan “Never mind how little you pay me, I can always work less”.

<sup>18</sup> Inflation was seen by most economists as a direct consequence of state spending and in particular social welfare blown up out of all proportion, paired with internal economic inefficiency [Andelman 1980, Bechtold and Helfer 1987].

support imports and service the country's growing foreign debt, mostly involving parastatal commercial banks). Net exporters to western markets were able to sell surplus foreign currency to the banks, earning attractive premiums in local currency. Although this practice stimulated exports, it had major negative effects. The export premiums and profits from inflation-related currency speculation distorted the pricing of goods and services in product markets both locally and in exports, leading some companies to the wrong conclusions about their true competitiveness. Also, access to cheap loan financing due to state-subsidized interest rates in the hyperinflation period was a major potential source of advantage exploited by many companies.

The effects of hyperinflation are familiar from research carried out in other countries, particularly Latin America<sup>19</sup>. Out of those present at the micro level, three were in my opinion particularly important for later managerial behavior. The first was the problem hyperinflation created for accounting. Local accounting standards were already outdated by the time inflation started to climb, and official financial statements soon became meaningless. In order to keep track of true company performance managers had to establish parallel bookkeeping, typically recording all their transactions in German Marks<sup>20</sup>. While on the one hand the transparency of performance decreased, on the other the situation forced the more entrepreneurial managers to learn a great deal about accounting, and cash flow management in particular. Obviously, tight cash management practices were paramount in solving the second problem resulting from hyperinflation, which was the massive lack of liquidity. Companies not handling their cash well found it losing value within a few days, since bank deposits bore interest far below the inflation rate. However, loan interest rates also did not keep pace with inflation, which prompted many companies to acquire significant debt. Finally, the situation resulted in a complete loss of confidence in the basic instruments of the state, and many companies began to break laws, claiming that otherwise they could not survive.

By 1989 the political monopoly of the communist party was fading and the voice of reformists within the party itself growing (especially in Slovenia and Croatia), as was pressure from other political groups, some of which started to mobilize civil initiatives. Also, by 1989 the elite had become extremely divided in their views of the proper model for future development. Mr. Slobodan Milošević based his political power on popular nationalistic sentiments in Serbia. In promoting the interests of his constituency, he in practice cast a vote in favor of conservative communism and a strongly centralized country. At the other extreme were Mr. Milan Kučan and Mr. Ivica Račan, trying to balance the power in favor of Slovenia and Croatia. They both favored liberal socialism to the extent of readiness to dissolve the single-party system, and called for even more decentralization (towards a vision of a confederative state). Interestingly enough, although the population in both Croatia and Slovenia in general disapproved of socialism (in particular the form built by the communist party), Mr. Kučan managed to keep his personal popularity high in Slovenia, while Mr. Račan failed to do so in Croatia.

Growing tension between rivals supporting two different models of political and economic development was also fueled by the huge regional differences in economic development in

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<sup>19</sup> For an excellent review of the broader links between inflation and the political, social and economic environment in Latin America see Dornbusch and Edwards (ed.) [1991]

<sup>20</sup> The DM also became the currency in which population kept its savings, since it was the major stable currency the population was exposed to through transfers from relatives working in Germany, and through dealings with German tourists visiting former Yugoslavia.

former Yugoslavia. The simplest illustration of this is in GDP per capita data for individual republics and autonomous provinces (Table 2.2): despite a slowly closing gap (in relative terms, but growing in absolute terms), in 1988 Slovenia still had a more than 7 times greater GDP per capita than Kosovo. Similar conclusions can be drawn from data on trade among the republics (Table 2.3), with Slovenia showing a positive trade balance with all republics and Croatia a positive balance with all except Slovenia.

|                          | 1980 | 1988 |
|--------------------------|------|------|
| Yugoslavia               | 100  | 104  |
| Bosnia and Herzegovina   | 71   | 77   |
| Croatia                  | 135  | 139  |
| Macedonia                | 86   | 90   |
| Montenegro               | 66   | 66   |
| Serbia                   | 78   | 83   |
| Serbia without provinces | 76   | 81   |
| Kosovo                   | 25   | 29   |
| Vojvodina                | 134  | 141  |
| Slovenia                 | 195  | 204  |

Source: Yugoslav statistical yearbook [1990]

Table 2.2 Relative GDP per capita in former Yugoslavia

(average GDP per capita for Yugoslavia in 1980 (US\$4,840) = 100)

|                        | Bosnia and Herzegovina | Croatia | Macedonia | Montenegro | Serbia | Slovenia |
|------------------------|------------------------|---------|-----------|------------|--------|----------|
| Bosnia and Herzegovina | -                      | 73%     | 99%       | 142%       | 85%    | 66%      |
| Croatia                | 138%                   | -       | 103%      | 366%       | 107%   | 78%      |
| Macedonia              | 101%                   | 97%     | -         | 193%       | 94%    | 76%      |
| Montenegro             | 70%                    | 27%     | 52%       | -          | 57%    | 30%      |
| Serbia                 | 117%                   | 93%     | 106%      | 175%       | -      | 63%      |
| Slovenia               | 151%                   | 129%    | 131%      | 332%       | 159%   | -        |

Source: Yugoslav statistical yearbook [1991]

Table 2.3 Trade balance among the republics of former Yugoslavia in 1987

(as percentage of purchase from a republic covered by sales to it)

In addition to differences in GDP and the lack of trade balance, two other basic economic patterns created significant tensions. Internal migration flows dictated by job availability followed the “south to north” pattern, while cross-regional investment patterns took a clear “north to south” direction<sup>21</sup>. The reasons are simple to understand and are mostly familiar from studies of similar social phenomena [Fayerweather 1982, Kirschenman and Neckerman 1991, Bakan and Stasiulis 1997]. More developed regions distrusted the consequences of a large inflow of low-skilled labor unwilling to assimilate with local culture, while less-developed regions objected to the unequal treatment their citizens received when migrating internally. Investment-related problems were somewhat more complex. While the argument

<sup>21</sup> It is interesting to compare these two patterns with those on the EU scale or within EU countries with clear differences in regional development, such as Italy. While “south to north” (or from less developed to more developed countries / regions) labor migration patterns are obvious, “north to south” investment patterns are not observable under normal market circumstances (e.g. in 1998 Portugal received 0.1% of cross-country FDI within EU, half of it from Spain [Eurostat 1999]) and, if present (as in Italy) are primarily the result of political intervention.

of “neo-colonization” raised by the less-developed regions is familiar from the experience of other countries, complaints on the part of developed regions to a large degree reflected the political nature of investment mechanisms. On the one hand, most investments were not made directly by business entities, but by the political elite of less-developed regions out of funds collected through a specific tax on more developed regions (a compulsory “contribution to less developed regions” based on a sophisticated calculation corresponding roughly to between 1.8 % and 2.7 % of revenues). Even direct investment was, given the nature of the ownership system in former Yugoslavia, not fully under the control of a mother company’s management, and the threat of legal separation of subsidiaries from the parent was ever-present. Needless to say, there were no direct profit transfers to the mother company: profits were mostly deployed to support generous employee benefits in the subsidiary.

Rising tensions in former Yugoslavia in the late 1980s started to affect the economic flow between republics. This was especially true for sales of Slovenian (and to some degree Croatian) goods in Serbia and Montenegro, as they were objects of semi-official boycott<sup>22</sup>. This was a clear source of threat, since the markets of the other republics were important targets for both Croatian and Slovenian companies (Although official statistics on trade among republics were not precise, an estimated 35% of Croatian and Slovenian GDP was based on sales to other republics within former Yugoslavia.)

### **2.3 Adaptation to discontinuous (1991-1994) and continuous (1994-2002) change**

Despite the warning signals, many companies in former Yugoslavia were taken by surprise when the violent disintegration of former Yugoslavia commenced in 1991. To make matters worse, the scenario coincided with the collapse of trade with COMECON countries. Statistically speaking, the average Slovenian company lost about two-thirds of the market within a few months. Even without other changes, this would by any definition constitute change of a discontinuous nature [Ansoff 1988, Meyer et al. 1990]. However, as described below, the political, social and economic environments in the region continued to change at a rapid pace.

While the detailed case analysis presented in Chapter 5 depicts the varied spectrum of the anticipatory actions which decreased the stress level for some companies, at this point a general observation seems to be valid. The turbulent economic and political environment of former Yugoslavia in the late 1980s required from companies (and in particular their top management) rapid adjustment and the ability to cope with a high level of uncertainty. It also offered hugely-rewarding opportunities, linked to risks that at the time appeared primarily political. A high level of anticipatory adjustment was simply unlikely, because it was viewed as politically incorrect and did not maximize short-term opportunities.

#### **2.3.1 Changes in the political, economic and social environment**

Under growing public pressure, the political elite of Croatia and Slovenia decided to activate the existing constitutional arrangement allowing elections to be held for parliaments within the individual republics of former Yugoslavia. While in the past only candidates sponsored by the communist party were eligible to stand, in 1989 Croatia and Slovenia decided to allow the formation of political parties, who would nominate their own candidates. As a result, the first

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<sup>22</sup> The most popular daily newspaper in Serbia, “Politika”, published commentaries and statements by some of the more outspoken Serbian politicians (e. g. Rada Anđelković) almost daily which blamed Slovenia for “enslaving” the Serbian economy.

free elections were held in 1990. The reformed communist parties lost in both countries. In Slovenia, the ruling coalition comprised several parties (in the Slovenian political arena centrist or right-wing) with a broad range of political agendas, but united in their opposition to the continuation of socialism as a dominant political and economic concept. In Croatia, the Hrvatska Demokratska Zajednica (HDZ, Croatian Democratic Alliance) led by Franjo Tuđman won a majority in parliament on a clear nationalist and populist political platform, but it had less clear economic proposals, except for a call to privatize the economy. “Social justice” was loudly declared a priority in both countries, despite their denunciation of socialism.

In December 1990 Croatia and Slovenia held referendums on whether to stay within former Yugoslavia or to declare independence. The vast majority of voters favored independence, which both countries proclaimed in June 1991. A short military conflict with the Yugoslav army took place in Slovenia after its declaration, but within less than a month the army pulled out. However, after doing so it regrouped, and by September had intensified its engagement in Croatia, where armed conflict had in the meantime developed between part of the Serb minority (primarily those in rural areas) and the Croatian authorities. Military conflict in Croatia escalated<sup>23</sup>, and about one-third of the country’s territory came under the control of a self-proclaimed Serb local government backed up by the Yugoslav army. This situation lasted until 1995 (the last remaining occupied territories, including the city of Vukovar, returned to Croatian control in 1998), producing many casualties and much material damage<sup>24</sup>, together with a high level of indirect damage associated with the severe social effects of war and disruption of economic activities throughout Croatia.

Politically, the period between 1991 and 1998 in Croatia was characterized by the strengthening of Mr. Tuđman’s presidential rule and the growing influence of his party. After a short period of broad coalition government (designed to cope with the growing danger of Croatia’s loss of the war for independence and sovereignty), HDZ reaffirmed its leading position, in the face of growing concern from the opposition and foreign observers that the country was not developing its democratic institutions fast enough, even if war conditions and the post-war recovery were taken into consideration. Mr. Tuđman ruled the country in a singularly autocratic manner until his illness and death in 1999. HDZ was defeated in the elections in January 2000 and was replaced by a broad coalition of mostly leftist and centrist parties led by Mr. Račan’s (reformed communist) Socijalno Demokratska Partija (SDP – Socialist Democratic Party). Only following the change of government did the international community fully accept Croatia as a democratic country and lift objections to its participation in important regional initiatives<sup>25</sup>.

In Slovenia, the initial broad coalition was replaced in May 1992 by a centrist government led by the Liberalna Demokracija Slovenije (LDS - Liberal Democratic Party) and Mr. Janez Drnovšek. Mr. Drnovšek and his party stayed in power throughout the period 1992 to 2002 with the exception of a few months in 2000. However, he frequently changed coalition partners, drawing from both the left and the right of the Slovenian political spectrum. Mr.

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<sup>23</sup> Formally, the legal question of whether Croatia was engaged in a war with Yugoslavia or was dealing with armed civil unrest on its own territory remains a matter of political and legal debate. For this thesis I find the question irrelevant, and use the term “war” since it is in everyday use in discussions of that period of Croatian history.

<sup>24</sup> An estimated 12,000 people died in the conflict, 35,000 were wounded, and 500,000 were displaced (more than 10% of population); direct material damage was estimated at US\$ 27 billion, or almost double the Croatian GDP in 1990.

<sup>25</sup> Before this, for example, Croatia could not participate in EU projects such as TEMPUS.



Kučan was another symbol of political stability: he was elected as the first President of the Republic of Slovenia and remained in that position until the end of his second mandate in the autumn of 2002. Democratic institutions were, by independent accounts, developed fairly effectively.

Major reform of the political system and the necessary constitutional reforms were concluded in both countries by 1992, but changes in their legal systems, together with legislation of significant economic import, although ongoing in this period are still incomplete<sup>26</sup>. The magnitude of legal reform is mind-boggling. Both countries had to revise their entire legal frameworks, and most laws needed significant alteration, some being written for the first time. In addition, while a major part of legislation was revised during the early period of independence, a second round of major change was initiated after 1996 with EU requirements in mind. Overall, tens of thousands of changes in laws and regulations have been passed via the parliamentary process in these two countries.

The scope and magnitude of changes in the economic systems of the two countries followed political developments closely. Interestingly enough, although the economic results differ significantly in Croatia and Slovenia, key areas of economic intervention and many interim manifestations have been the same.

Croatia and Slovenia, like other countries in the region, shared the first economic manifestation of the change process: a significant drop in GDP level occurring in the first years after the introduction of true reforms (Fig. 2.1). It is interesting to note that the dip in GDP is both deep and wide, and that even the most robust economies in transition have needed more than eight years just to return to pre-change GDP levels. Also, many countries show a leveling-off of recovery towards the end of the period, this to large extent influenced by the Russian crisis of 1998. There were several important consequences. In economic policy, governments obviously had to cope with the issues of recession, structural adjustment and growth. To complicate things further, the recession began in the period of hyperinflation, and suffered the adverse influence of other key factors such as pressure from the international community to open local markets fully<sup>27</sup>. Since none of these issues could be solved in the short term, the governments also had to pay the political price of lack of quick fixes for problems which were hitting their constituencies hard.

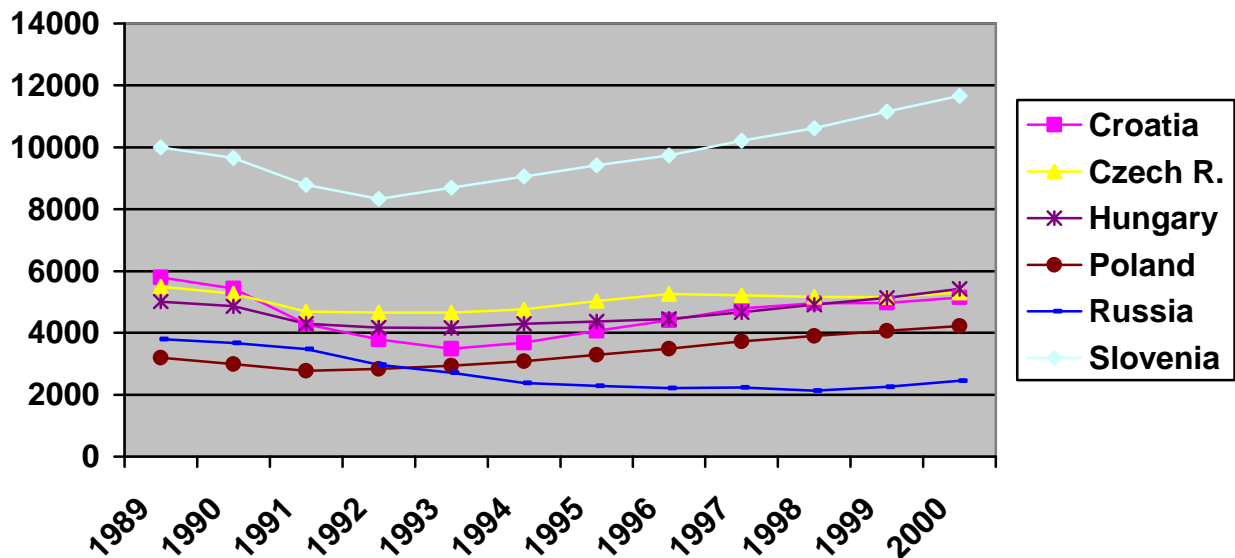
Another major issue for both governments surrounded the respective establishment of national currencies and definition of monetary policy. On the one hand, it was obvious that the Yugoslav Dinar could not be retained, but it was less clear how and how quickly new currencies should be introduced, positioned and managed. Even the names of their currencies became a political issue in both countries. The Slovenian government used this as a practical argument to introduce its currency in two stages: banknotes without any currency name were first introduced as a temporary payment instrument, and only when inflation had subsided and trust in the banking system and government competence had been established was the new

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<sup>26</sup> E.g., in May 2002 the Slovenian parliament passed a law on privatization of insurance companies, and the major current shareholders have already announced that they will challenge it in the Constitutional Court.

<sup>27</sup> Jeffery Sachs was the leading proponent of “shock therapy”, in favor of which he argued vigorously as consultant to numerous governments in the region and through his influence on the policies of the International Monetary Fund [Sachs 1992, Sachs 1996]. However, he was only voicing the general sentiment shared by most influential political and business circles in the West, which was largely driven by the pragmatism of opening untapped markets, rather than by a clear understanding of the benefits of such liberal policies. Some academicians did openly criticize the IMF approach and Sachs’s views, but to little effect [Kregel and Matzner 1992, Hanke and Walters 1993, Slay 1993].

currency (the Slovenian Tolar) introduced. To build the confidence of the general population, both governments maintained a consistent policy of slightly overpricing their local currencies, which put significant pressure on exporters and the countries' trade balance<sup>28</sup>. While the Croatian government and its central bank authorities hoped the gap would be closed by income from tourism, FDI and money transfers from citizens working abroad, Slovenia placed its bets on the vitality of its exporters.



Source: EBRD Transition Report [2002], World Development Indicators Database [2002]

Figure 2.1 GDP per capita (in constant 1995 US\$) for selected countries in transition in the period 1989 – 2000

The monetary policy in the early days of independence was strict and inflation decreased in a relatively short period of time, although both countries avoided the extreme shock therapies recommended by the IMF. However, even with relatively soft steering, the real cost of short-term financing soared. The first reason was both countries' political decision not to provide hidden subsidies to companies through soft loans. The second was the change in the banking sector, where banks were required to clean up their lending portfolios as well as their non-performing assets. They were also supposed to be profitable and manage their cash flow without significant central bank intervention. Within months it became clear that most banks would go bankrupt under these conditions, so governments intervened and nationalized them to keep them afloat. However, tight lending practices and greatly increased interest spread to cover costs emerged as the consequences of this state intervention. In real terms, the annual interest rate on short-term corporate loans approached 20% and remained above 12% for most of the period between 1991 and 1995. For companies dependant on loan financing this was a huge shock, since the real interest rate at times of high inflation in former Yugoslavia had often been negative, and loan repayment schedules could easily be renegotiated.

The banking system in Croatia suffered severely from political intervention during the privatization process, as described below. Several banks collapsed in the late 1990s, but the

<sup>28</sup> A simple calculation shows that the difference between the inflation rate and local currency devaluation remained at between 3% and 5% during most of the period, both in Slovenia and Croatia (although numbers differ by year and by country). This put high pressure on exporters who accrued most of their costs in the local currency.

damage was limited and the government encouraged sales of all important banks to foreign-linked investors. Here the strategy after entry was, up to mid-2002, to maximize local gains, without significant restructuring. The banking system in Slovenia was fully restructured and rehabilitated by 1997, when the interest spread began to decrease and corporate lending became more active. Occasional turbulence resulted from the sub-standard performance of several smaller and mid-size banks, and consolidation led by the largest banks in the country. By 2002 foreign banks had gained a foothold through “green-field” subsidiaries or via acquisition of smaller banks, but this did not develop to significant dimensions. In 2001 the state began the privatization of the two largest banks (with a combined market share of more than 60%), but this process proved to be highly political, with strong opposition from public opinion.

With the exception of the financial sector (banks and insurance companies) and the traditional state monopolies, most corporate privatization in Croatia and Slovenia was carried out in the period from 1992 to 1996. It was certainly in the privatization process that the economic policies of Croatia and Slovenia differed the most; and it had a major impact on the behavior of individual companies [Smith et al. 1997, Franičević 1999, Bojnec 1999].

The new political elite in Croatia designed the privatization process there, and Mr. Tudman and his party tightly monitored its implementation. The rationale behind the process was a desire to generate FDI and achieve a level of concentrated ownership high enough to drive companies towards fast improvement in performance. The privatization process for smaller and middle-size companies was typically not transparent, but was decided within the Croatian Privatization Agency. In most cases company value was understated, and a company was sold to the individual with the closest ties to the political elite<sup>29</sup>. Instead of generating an inflow of fresh capital<sup>30</sup>, the transaction was covered by a bank loan to that individual, approved by a “friendly” government-controlled bank (or, in some cases, foreign loans, when the individual had already accumulated enough assets to use as a guarantee against new loans). These practices had several significant consequences. In the process of preparing for privatization, many companies were literally forced into destroying value, often by their own management, who hoped to buy the company at a low price. Some of the new owners were genuinely interested in the companies they bought as going concerns, but many saw the purchase as a transaction, stripped the company of its assets (often illegally) and let it fail. This weakened the banking system due to the resulting substantial number of non-performing loans. Finally, the whole process generated a huge degree of opposition and cynicism in the population, and eventually contributed to the change of government in 2000. However, not all the cases developed according to the above scenario. Respectable foreign owners bought some companies (typically in “low risk” industries like cement or brewing), while a number of the biggest and best-performing were floated on the local or (in a few cases, like Pliva and Zagrebačka banka) international stock exchange, with a significant portion of shares owned by institutional investors.

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<sup>29</sup> The process to large degree resembles privatization in Russia [Buck et al. 1999] and other East European countries with authoritarian regimes.

<sup>30</sup> The Croatian Privatization Fund (CPF) had up to 1997 sold only around US\$ 200 million of equity to foreign investors, 1/3 of it to Croatian émigrés. The overall cash proceeds from privatization were by that time only around US\$ 275 million out of an estimated US\$ 2.6 billion of the initial value of CPF-held equity [Franičević 1999]. In comparison, more than US\$ 1.5 billion was raised through sales of socially-owned apartments [EBRD 1997] – citizens obviously preferred to invest their savings in buying housing rather than stock, which was perceived as highly risky.

The Slovenian privatization process was based on a different set of assumptions: social fairness was seen as the most important criterion by far, as was clearly stated by the vast majority of the population. Given the fragmentation in parliament, it comes as no surprise that no political party wanted to take the risk and openly oppose the privatization concept even if some part of the political elite preferred a different model. This is why voucher privatization followed<sup>31</sup>. Also, public opinion was consistent in its strong opposition to sales of Slovenian companies to foreign owners, this reflected in fairly closed capital markets and the relatively low level of FDI in Slovenia as compared to some other Central European countries (Table 2.4). In consequence, most of the biggest and best-performing companies in Slovenia are in the majority ownership of domestic institutional investors.

|                | Cumulative FDI per capita<br>(US\$) |
|----------------|-------------------------------------|
| Croatia        | 1042                                |
| Czech Republic | 2399                                |
| Hungary        | 976                                 |
| Poland         | 961                                 |
| Slovakia       | 1109                                |
| Slovenia       | 840                                 |

Source: EBRD Transition Report [2002]

Table 2.4 Foreign Direct Investment in Central Europe, 1993 - 2001

It might be appropriate to conclude this brief overview of economic changes in Croatia and Slovenia in the period from 1991 to 2001 with the most recent developments (Table 2.5).

|                           | Croatia |        | Slovenia |        |
|---------------------------|---------|--------|----------|--------|
|                           | 2000    | 2001   | 2000     | 2001   |
| GDP (mil. US\$)           | 19 223  | 20 260 | 18 146   | 18 810 |
| GDP per capita (US\$)     | 4 179   | 5 354  | 9 073    | 11 984 |
| GDP PPP per capita (US\$) | 7 960   | 9 170  | 17 310   | 18 233 |
| GDP growth (%)            | 3.7     | 4.1    | 4.6      | 3.0    |
| Inflation (%)             | 6.2     | 4.8    | 8.9      | 9.4    |
| % of unemployed           | 21.1    | 22.0   | 10.8     | 10.8   |

Source: EBRD Transition Report [2002], World Development Indicators Database [2003]

Statistical Bureau of Croatia, Statistical Bureau of Slovenia

Table 2.5 Key economic indicators for Croatia and Slovenia in 2000 and 2001

Regional markets have in principle fully re-opened to companies from these two countries, including those in Bosnia and Herzegovina, Serbia and Montenegro. Of course, the situation is significantly different from that ten years ago. Competition throughout Central and Eastern Europe is getting stronger by the day, comprising not only the more aggressive global players, but also emerging local and regional competitors. The absence of strong local competition in some countries is usually linked to their low purchasing power (cf. Serbia, Albania or Moldavia). On the other hand, Croatia and even more so Slovenia are becoming increasingly more integrated into the European business environment, even before becoming formal

<sup>31</sup> The privatization process in Slovenia largely resembles that in the Czech Republic.

members of the EU<sup>32</sup>. An examination of FDI and foreign trade sources clearly indicates that the EU is already the prime economic partner of the two countries, followed by countries of former Yugoslavia and former COMECON countries (Table 2.6).

|                                    | Croatia  |              |              | Slovenia |              |              |
|------------------------------------|----------|--------------|--------------|----------|--------------|--------------|
|                                    | % of FDI | % of exports | % of imports | % of FDI | % of exports | % of imports |
| EU                                 | 72       | 55           | 65           | 84       | 62           | 69           |
| Former <sup>33</sup><br>Yugoslavia | 3        | 26           | 10           | 2        | 17           | 5            |
| Former<br>COMECON                  | 1        | 5            | 16           | 4        | 12           | 11           |
| North<br>America                   | 18       | 2            | 3            | 4        | 3            | 3            |
| Other                              | 6        | 12           | 6            | 6        | 5            | 11           |

Source: Internal materials of Statistical Bureau of Croatia, Slovenian Chamber of Economy

Table 2.6 Geographical structure of principle international economic relations in 2001

The situation, however, varies significantly according to industry sector. In general, consumer goods industries have found their best markets in the countries of former Yugoslavia, followed by the EU, while those for industrial goods are found primarily in the EU, followed by countries of former Yugoslavia. As to consumer industries, former COMECON countries represent smaller, but still very promising markets, with the situation varying from one sector to another (e.g. for pharmaceuticals this is the leading market). All other markets are marginal. An example of the market structure for Slovenian food and car components industries is provided in Table 2.7.

|                                    | Food industry |              | Car components industry |              |
|------------------------------------|---------------|--------------|-------------------------|--------------|
|                                    | Mil. US\$     | % of exports | Mil. US\$               | % of exports |
| EU                                 | 76            | 23.6%        | 234                     | 89.0%        |
| Former <sup>34</sup><br>Yugoslavia | 214           | 66.5%        | 19                      | 7.2%         |
| Former<br>COMECON                  | 19            | 5.9%         | 3                       | 1.1%         |
| North<br>America                   | 11            | 3.4%         | 2                       | 0.8%         |
| Other                              | 2             | 0.6%         | 5                       | 1.9%         |

Source: Internal materials of the Slovenian Chamber of Economy

Table 2.7 Geographical structure of exports of Slovenian food and car components industries in 2001

The social effects of the political and economic changes described are overwhelming. Without entering into a detailed analysis of the growing body of social and economic research

<sup>32</sup> Slovenia had by mid-2002 concluded 26 out of 31 chapters in its negotiations for accession to the EU, and was among the front-runners for candidacy.

<sup>33</sup> The data includes numbers for Slovenia in the case of Croatia, and vice-versa.

<sup>34</sup> The data include numbers for Slovenia in case of Croatia and vice-versa.

[Milanovic 1999, Mandič 2000] (which is beyond the scope of this study), one can easily identify several phenomena affecting the behavior of stakeholders in companies undergoing change.

The early period of the change process (1991-1994) was characterized by high levels of uncertainty and disorientation. Social symbols were changing in value overnight, with some of the most basic manifestations of culture also metamorphosing and requiring rapid adaptation<sup>35</sup>. This, along with decreased physical and economic safety, generated high stress levels. Naturally, Croatia suffered from it more than Slovenia, since it was exposed to a much more serious military situation and a much longer economic depression.

While the vast majority of the population welcomed the independence of their countries and the change from a socialist to market economy, it also had quite naïve expectations regarding the speed of economic turnaround. The short-term results of the changes were a significant drop in the standard of living, and, in order to retain at least some voter support, governments were tempted to promise that “things would get better soon”. Of course, such promises were difficult to keep (Fig. 2.2) and, being suspiciously similar to promises offered for many years by the socialist governments, generated a significant amount of popular cynicism. It is worth noting that, if we take GDP as the measure of the economic situation, only five of the countries in the region have managed to return to where they started in 1989 and are now better off (Fig. 2.1). The others are still struggling with the price they must pay for restructuring their economies.

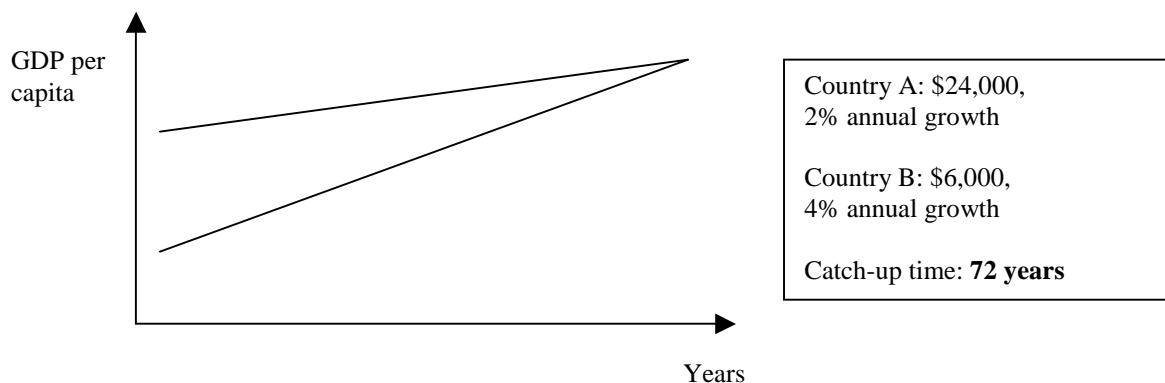


Figure 2.2 Illustration of linear catch-up

To a large degree cynicism was the principal feeling towards the western world. Many felt that western countries, after encouraging ex-socialist countries to begin the change, had left them out in the cold. Economic integration of countries in transition into the western economic space proved to be slow, and they received relatively little assistance (except during the reunification of Germany). While one can easily understand that disappointing early investment experiences (the inability of the Treuhandanstalt to sell East German companies at a profit; the poor performance of acquisitions such as GE Tungsram; the Russian crisis) and the region's lack of political stability led to the second-guessing of the true nature of business

<sup>35</sup> As an example, a mere reference to Yugoslavia, formally the source of collective identity, became a reference to an enemy state at war with Croatia and Slovenia. Another example is the everyday use of language as the basic manifestation of culture, where people were driven towards “purism”, i.e. strict avoidance of words and jargon associated with other cultures, or the Yugoslav (or socialist) past. In Croatia this produced significant changes in the language, often with strong political connotations (e.g. a preponderance of words previously heard only at the time of nationalistic, pro-Nazi government during World War II).

opportunities, it threatened to turn the virtuous circle of economic recovery into a vicious one of continuous downturn (Table 2.8, Fig. 2.3). Part of this was a gradual rise in negativity towards the presence of foreign investors in both countries (e.g., in a recent poll more than 50% of Slovenians opposed the sale of Pivovarna Union, the second largest Slovenian brewery, to Interbrew)<sup>36</sup>, further contributing to the vicious circle.

Cynicism was not only the result of adjustment stress and betrayed expectations of improved standards of living. Other social factors engendering it included the significant increase in wealth concentration (more prevalent in Croatia, due to its privatization model), a relatively thin social safety network, and the impoverishment of many who, prior to changes, had belonged to the middle class. Furthermore, many of the opportunities created in the transition and the relatively weak state of the law solicited corruption. The media reported social aberrations much more readily than it did anything positive, thus reinforcing the ordinary citizen's impression of failing societal norms. Increased stress, as well as the impact of western social trends on the younger generation, contributed to the rise of drug abuse and crime in general. With the legal framework in flux, general environmental uncertainty and abundant opportunities for high gain proved particularly challenging for managers, who showed massive disrespect for the law, following the trend in other countries in transition (e.g. more than 70% of Polish managers admitted breaking the law [Czapinski 1996]).

On the positive side, both countries witnessed a mushrooming of entrepreneurship, seen in the founding of several hundred thousand small new companies, as well as the population's booming interest in active participation in stock markets and other forms of revenue-generation (such as taking jobs on the side as sales representatives of direct sales organizations).

|                               | FDI (in EUR billion) |
|-------------------------------|----------------------|
| Other countries within the EU | 329                  |
| USA                           | 174                  |
| Central and Eastern Europe    | 12                   |
| Other                         | 86                   |

Source: Eurostat [2001]

Table 2.8 Destination of FDI of EU countries in 2000

Croatia had another specific problem, comparable to the "Vietnam syndrome" in the USA. A large number of young men were discharged from the army after military operations concluded. Many of them suffered from war-related disorders, which were further intensified by poor employment opportunities and quick social marginalization.

Finally, both Croatia and Slovenia witnessed growing individualism and conservatism as another form of response to the social problems described above. Especially among the younger workforce, this coincided with the effects of "Generation X", as described in the literature [Tulgan 2000, Karp et al. 2002].

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<sup>36</sup> Once again, Croatia and Slovenia are not exceptions in Central Europe. A negative attitude towards foreign investors has developed in all its countries, even in those (such as Hungary), where feelings were initially positive and where foreign investors reacted with enthusiasm, bringing a significant amount of investment [Martin 1999].

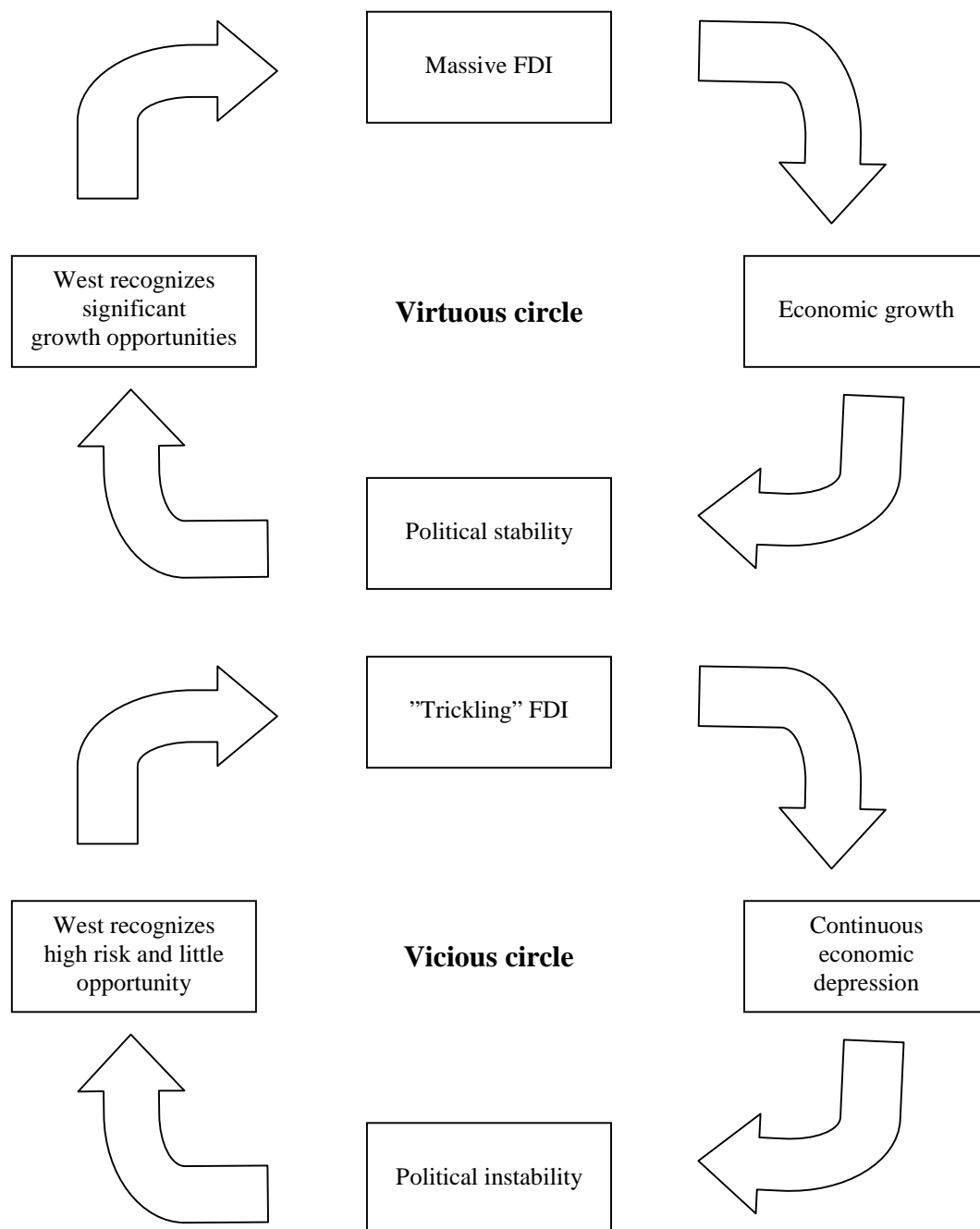


Figure 2.3 Virtuous circle of economic recovery and vicious circle of continuous downturn in countries in transition

### 2.3.2 Key challenges and responses on the corporate level

The obvious major challenge for a company at the beginning of the period of change was to stay alive in an environment of failing markets and enormous pressures on cash flow. It was not uncommon for a company to remain without any significant revenues for months, forcing management to devise survival tactics involving possible sources of short-term financing. Basic logic indicates two components of the problem: cash-flow management as an immediate issue, as well as balancing costs and revenues as a matter of recreating a sustainable business.



Solving the cash-flow problem was far from trivial. On the one hand, banks were experiencing significant problems themselves and loan financing suddenly became very expensive, while money from other sources was usually even more expensive. Many managers applied the old habit of using political connections, with varying success. In some cases, managers were not close enough to the new elite (especially incumbent managers who had not switched political sides fast enough), and in others politicians did not wish to expose themselves to the risk of public scrutiny for behavior that was no longer to be tolerated. Along with seeking out possible sources of extraordinary cash infusion, managers also turned their attention to improving cash-flow management practices. They also had to devote great attention to reaching agreements with employees and suppliers allowing them to delay salary payouts and stretch out account settlements, in order to avoid strikes or stoppages caused by lack of raw materials – which would generate that fatal spiral of downturn in operational activities (and, consequently, of revenues and cash).

As regards balancing costs and revenues, it soon became clear that cutting costs could be achieved faster than building new streams of revenue. Thus, many companies decided on cost-cutting exercises. One of the clearer and less painful was to focus on closing down or spinning off activities with minimal potential for generating profit, as well as those that could be easily subcontracted<sup>37</sup>. Also, given traditional levels of over-staffing, especially in administrative overheads<sup>38</sup>, many companies when faced with the need to make additional savings undertook major personnel reduction<sup>39</sup>. They also looked at other costs they might influence, primarily in the area of purchasing. Finally, they began examining business processes, and a number underwent formal re-engineering. Thus, as one might easily see and predict from experience elsewhere, a spectrum of approaches and tools were used to optimize the cost position.

At this point it should be noted once again that the major incentive for cost-cutting at this initial stage of change was not to achieve sustainable cost advantages over competition, but to confine costs within downscaled revenues and thus assure short-term survival, which was in jeopardy! Labor cost advantage, as will be discussed in Chapters 3 and 5, proved to be an elusive issue. While many local managers believed they could sustain and use it on their own or as a basis for some form of alliance with foreign partners, the behavior of MNCs [Meyer 1995, Filipović 2000], confirmed Porter's prediction that labor costs alone are a poor attractor and that more complex factors influence MNCs in their investment decisions [Porter 1986].

Some companies were, for various reasons (unwillingness to admit the unpleasant truth; internal or community pressure to keep employment level; lack of leadership drive or managerial skills and systems), hesitant or slow to reduce costs. As one might expect, there were plenty of failures. However, some companies who were relatively successful in initial cost cutting did not achieve the further progress of some of their counterparts. Also, some other companies who survived the initial adaptation did not initially do so by means of

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<sup>37</sup> This typically involved various employee benefit services (e. g., vacation resorts, childcare facilities, cafeterias etc.), as well as low-skilled jobs (e. g., security or cleaning staff).

<sup>38</sup> For example, Žito, one of the largest food companies in Slovenia, in 1991 had headquarter costs equivalent to 5.8% of sales, while headquarter costs of 22 international food companies on average equalled 1% [EMBA Projects 1992].

<sup>39</sup> However, due primarily to institutional pressures in almost no case did reduction in labor costs match decrease in revenues. The same pattern was observable in all other countries in the region except Hungary. The discrepancy between revenue and employment drop stood in direct correlation to the speed of reform [Martin 1999].

significant cost cutting, but instead focused on building new streams of revenue. However, over a period of time virtually all the companies which survived did both, i.e. trimmed costs and looked for new sources of revenue.

In seeking new revenue opportunities, many companies behaved opportunistically, and tried various avenues. In geographical terms, it became obvious that the newly redefined local market (be it Croatia or Slovenia) offered smaller potential than the market of former Yugoslavia. With failing COMECON markets, it seemed to be a natural choice for companies to seek new opportunities for existing products in the developed markets of the EU and other western European countries. However, very few companies had competitive products, and even fewer had developed sales channels. Thus, they chose a variety of strategies (developing new products, an attempt to penetrate local markets on wider scale, betting on Central European markets, switching to a mix of brand and private label production etc.), with a wide variety of outcomes.

It is worth noting that in terms of initial company size the situation in Croatia and Slovenia differed from that in COMECON countries. State-owned giants (Kozminski [1993] refers to them as dinosaurs) virtually did not exist in former Yugoslavia. Nevertheless, almost all the large companies, excepting state monopolies such as the post office or the railways, underwent fragmentation and significant downsizing, some practically ceasing to exist<sup>40</sup>. This process significantly affected the ability of the restructured companies to compete in global markets, since they lack the critical mass unless competing in small niches<sup>41</sup>.

If the major external challenge for companies was to right-size, focus on their core business and find an appropriate cost-revenue balance, the major internal challenge was to survive this process without suffering collapse from human factors. As described before, cynicism, disorientation and lack of motivation were the prevailing attitudes generated by the change in the environment. Employees saw no easy answers to the huge problems companies were facing, and often responded by choosing “flight” over “fight”. On the other hand, the opportunities arising from discontinuous change (as in privatization) frequently stimulated unethical behavior, creating additional problems for company morale. Combined with the psychological issues in downsizing, all these elements presented a clear leadership challenge (i.e. the challenge of leading and managing the transformation effort).

New challenges emerged for companies who had survived the initial period and were subsequently privatized. On the one hand, these reflected the objectives of the new owners, who in many cases were seeking higher short-term profitability<sup>42</sup>. On the other hand, although the pace of change in the local environment had slowed to some degree, there were still

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<sup>40</sup> Good examples are Iskra and Rade Končar, both among the leading companies in former Yugoslavia, jointly employing over 55,000 people. Iskra (a Slovenian electronics manufacturer) disintegrated into a myriad of small companies, some of which altered their name, while more than 60 still maintain symbolic ties with history. Rade Končar changed its name to Končar, went through a turbulent process of downsizing (to about a sixth of its initial size), and reemerged as a group consisting of 55 small companies.

<sup>41</sup> The same effect was observed in other countries of the region, where the disintegration processes were even larger in scale [Amsden et al. 1994].

<sup>42</sup> This seems just as true for single owners or small groups of owners purchasing a company through an LBO-type arrangement as for institutional investors, and is in both cases completely logical. The first group was under the pressure of debt repayment and in most cases could not employ the asset-stripping tactics typical of developed markets, since the asset market was suffering from oversupply due to many failing companies. The second group was also dependant on short-term profits rather than capital gains, since the stock markets were not liquid and the choice of investment positions was limited.

profound new factors increasing pressure on performance. In local, regional and international markets companies were faced with growing competition. The local market had more or less fully opened to global players who used the less-risky environment to justify their entrance (this happened in Slovenia somewhat earlier than in Croatia, but by the late 1990s both countries were in a similar position). Also, new local competitors emerged, and some old ones significantly improved their performance. The same became true in the regional markets of Central Europe, with clear trends in the same direction in the markets of former Yugoslavia's other republics. As regards the developed markets, the global trend of increased competition was matched by the penetration of more competitors from countries in transition, who followed similar strategies to Croatian and Slovenian companies and approached them in performance. This was especially troublesome for local companies competing on the basis of low (labor) cost for "reasonable" quality. Competitors from other Central and East European countries started to reach Croatian and Slovenian quality levels, but had lower costs (and the same physical proximity to West European markets).

This time the threat could not be countered by another round of fast cost-cutting measures (since many companies were already close to the industry efficiency curve), or by escaping to new markets (since most companies had already tried all close markets and were for obvious reasons reluctant to reach beyond Europe). Limited resources made it difficult to keep broad portfolios of products and market strategies. The domestic capital shortage did not permit the raising of capital for much-needed investment into product innovation<sup>43</sup> or market expansion. At the same time, pressures from both value-based and cost-based competitors made a "middle-of-the-road" position unsustainable. Thus companies were forced to develop a clear focus while improving their competitiveness. Psychologically this went against all past experience, since in more than a decade of abrupt changes companies had often survived not by focusing on one right answer, but by keeping many options open.

Under these circumstances the leadership challenge changed in nature, but did not disappear. Major company transformation was still required, as described above. The key challenge for leaders, however, was no longer to show that there was light at the end of the tunnel, but to convince stakeholders that a new tunnel existed – just after emerging in relief from the first.

## **2.4 Influence of the global business environment**

While changes in the environment in Croatia and Slovenia were occurring at a frantic pace, the global business environment was not at a standstill, either. Actually, many authors refer to the last decade as a period of discontinuous<sup>44</sup> change on the global level [Hamel 1996, Nadler and Tushman 1999, Bartlett and Ghoshal 2002, Eisenhardt 2002]. Naturally, global trends had a strong general influence on the competitive position of Croatian and Slovenian companies.

There is little doubt that in recent years business has become more global than ever. It is the rule rather than the exception nowadays for a large multinational company to operate in 150+ countries and territories. In many it not only sells and supports its products, but also develops them, buys components for them or produces them. Most industries have global players,

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<sup>43</sup> A study into the behavior of Hungarian companies showed that only 1 (domestically owned) of 27 firms in Hungary developed a new product as a reaction to crisis [Whitley and Czaban 1998]. On the macro level, investment in R&D decreased from 2-3% of GDP to less than 1% [Martin 1999] (in some countries, such as Poland, it was even worse: R&D expenditure dropped to less than 0.5% [Rapacki 1996]). Similar trends were observable in Croatia and Slovenia.

<sup>44</sup> The change they describe is discontinuous in terms of characteristics, if not in name.

including some that until recently were seen as strictly local, typically in services<sup>45</sup>. Thus, for the vast majority of companies facing the competition of global players in any desirable market is already a reality. In consequence, companies from Croatia and Slovenia cannot hope to remain viable just via the efficiency curve, but need a clear competitive advantage over global players in the eyes of their key customers. Thus, a major issue for them is what competitive strategies to choose when confronted with such competition.

In parallel with globalization of the competition, an opposite force is also influencing markets. Both consumer and business markets are becoming increasingly fragmented, since intensified competition has led many companies, understanding that customer segments were in the past often too coarsely defined, to refine their niches and shape customer expectations and demand. At the same time technological developments, primarily within information technology, have facilitated unprecedented developments in micro-marketing [Bessen 1993, Nadler and Tushman 1999]. For Croatian and Slovenian companies this trend has been a mixed blessing: while positive in generating additional market opportunities, favoring flexible (and not just big) players and bringing companies closer to customers and consumers, it has also created problems in setting even higher technological and marketing threshold standards.

Another recent phenomenon with a fundamental influence on business is the breakthrough progress in information technology. Without even speculating on its other effects, clearly visible is the impact it has had in virtually eliminating the significant barriers of time and space in many industries. On the one hand, it contributes to globalization, while on the other it increases the speed of the “internal clock” of business. For companies from Croatia and Slovenia it provides an opportunity as well as a threat. It is an opportunity in the broad sense that emerging technologies allow for radical redefinition of industries, thus eliminating the advantages of incumbents<sup>46</sup>. At the same time, however, local companies suffer relatively low levels of cumulative investment in IT, and from that point of view are at disadvantage compared to their western counterparts. Also, the increasing speed of business lays on more pressure to optimize business processes, already an area requiring their attention over the last decade.

The accelerated pace of technological change is another generally-accepted contemporary phenomenon. Its consequences are multiple. In some industries, technological change has led to significant shortening of product life-cycles and “hypercompetition” [D’Aveni 1994, Eisenhardt and Martin 2000], thus increasing the speed of business in a somewhat different sense than has IT. In addition, more importance is now placed on the knowledge necessary to master technological change and all its associated organizational consequences. In this sense many authors claim that we have already entered the “knowledge society”, in which capital is abundant and knowledge has become the primary driver of business success [Senge 1990, OECD 2000, Drucker 2001]. In organizational terms, novel organizational forms suited for creating and managing knowledge in organizations (e. g., learning, metanational and networked) have become a research focus [Senge 1990, Chisholm 1998, Doz et al. 2001]. There is little obvious evidence of how Croatian and Slovenian companies have reacted to this trend in the last decade, as they seem locked into traditional business structures and have

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<sup>45</sup> As an example, Service Corporation International by the end of 2001 operated 3,099 funeral service locations, 475 cemeteries and 177 crematoria located in 11 countries

<sup>46</sup> Recent research, however, suggests that this statement is only partially true. While “revolutionary strategies” are rendered more realizable by new technologies [Hamel 1996], it seems that incumbents are in a position to reap most of the benefits from internet technologies [Evans and Wurster 1999, Wise and Byrne 2000, Bigler 2001]

sought other ways to create added value. Nevertheless, every company must find its own approach to this issue, since the wrong choice can in the long run undermine viability.

The emphasis on the importance of knowledge has another important side-effect: redefinition of the contract between the corporation and the employee. The fact that the corporation owns the means of production does not secure its dominant position over the employee, as it used to in the past. If we link this to the Generation X effect [Tulgan 2000, Karp et al. 2002], and the changing relationship between employer and employee due to decreased job security, we see the theoretical underpinning for the observed phenomenon of decreased power of employers and the greater need to attract value-adding employees [Sherman and Sookdeo 1993, Pfeffer 1994, Hitt et al. 1994, Baruch and Hind 1999, Drucker 2001, Rubery 2002]. Croatian and Slovenian companies are starting to notice this phenomenon. In their case, the effects are magnified by the small local pool of labor, as well as the growing readiness of local talent to pursue international careers.

Finally, another universal trend has been reconfirmed over the last decade: in order to survive and thrive organizations must be able to institutionalize change, rather than stability. Whether this trend is new or has existed for ages and we merely flatter ourselves as “change masters” is a matter for discussion<sup>47</sup>, but organizations are undoubtedly keeping themselves in flux, experimenting with new forms and organizational development strategies, and seeking specific leadership talent. For regional companies this poses a true challenge, since until recently they were seen as key instruments in maintaining the status quo; and some key stakeholders still have an interest in opposing change [Kovač 1990]. Organizational and leadership development were of very secondary interest for the political and business elite, so companies have suddenly been faced with absorbing a tremendous amount of new learning in this area in a very short period of time.

## **2.5 Summary: characteristics of the research context and the resulting research agenda**

As with many similar research efforts, the main goal of this one is a better understanding of the patterns of corporate behavior which have led to success or failure in the observed period of radical change in Croatia and Slovenia (and which have the potential for general applicability to other scenarios of major change in the business environment). The huge variety of approaches to change observed, as well as the outcomes of the transformation, further stress the lack of simple answers. While such a broad issue may be difficult to address, the challenges presented in this chapter may allow more focus.

In terms of the contents of change, the issues point in the direction of competitiveness. Competitiveness emerges as central both in the first period of change, when companies struggled to adapt fast to the new environment and achieve an efficiency curve allowing them to be competitive in the redefined markets, and in the second phase, when companies have been trying to adapt to steadily-growing competitive pressures. Thus, competitiveness in a highly dynamic environment will present one dimension of the research model; and a literature review is presented in the next chapter as an aid to model building in this context.

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<sup>47</sup> Almost twenty years ago, Tichy [1983a] wrote in his article on strategic change management: “Organizations today face major, discontinuous change that makes strategic management more difficult and more complex than ever.” Given his deep understanding of change phenomena, one can only wonder how much more discontinuous change can become.

However, as seen from the above description of change and the resulting challenges, the process of change, in particular leadership intervention, seems to be an equally important component of the puzzle. With the high level of overall uncertainty, enormous daily pressures and significant general stress in society and among employees, managers did not have a simple task in designing and leading the change process. Thus, the change process itself will present the other dimension of the research model, also based on an appropriate review of the literature.

### 3. Literature review and research model

This chapter provides a literature review and presents a research model. The huge body of literature in the areas of competitiveness and strategic change management is a major challenge for the researcher. On the one hand, its volume makes any attempt at a systematic, detailed review almost futile<sup>48</sup>; on the other, various schools of thought and theoretical frameworks exist within each area. Thus, I decided to limit myself to a brief overview of the several major approaches in the literature, followed by a more in-depth analysis and discussion of those I find particularly relevant to the research goals specified in Chapter 1.

Based on the thinking presented in Chapters 1 and 2, I have chosen two subject areas for the literature review: competitive advantage and strategic change management. As Hirsch and Friedman suggested in their provocative article [1986], strategy formulation and implementation were traditionally kept as separate disciplines drawing on different underlying sciences (competitive advantage: economic theory and, to a lesser degree, military strategy; strategic change management: psychology, sociology and political science). While nowadays one seldom hears a serious scholar deny the importance of both streams, they are rarely present within the same piece of research. As will be discussed later, scholars from the “competitive advantage side” rarely address the *process* of transformation in the factors contributing to competitive advantage (i.e. the process through which companies change their competitiveness). For some schools of thought the obvious reason for such lack of attention to this important topic is the static character of the competitive advantage model. However, even schools that employ a dynamic model (e.g. the dynamic capabilities school, or the learning school) focus on the *what*, rather than on the *how* relative to dynamism.

Scholars from the “strategic change management side”, in particular those dealing with organizational transformation, tend to cover a broader range of questions about the nature of change, its context, content and process. However, most research focuses on one dimension only, and popular strategic change management models typically focus on process rather than other dimensions [Kanter 1985a, Kotter 1995]. A few notable exceptions to this rule will receive special attention in the review.

This chapter begins by looking at the concept of competitive advantage. First it presents a critical overview of the theoretical frameworks dominating recent academic as well as popular literature, the latter aimed at management practitioners and often prescriptive in form. Although there are implications for the research model in various economic theories, e. g. monopoly theory, transaction cost economics theory, organizational ecology and institutional theory, special focus is placed on the environmental school (presented in 3.1.8). The main reason for this choice is not only the popularity of this theory with practitioners (mostly due to the influential work of Michael Porter [Porter 1980, 1985]), but the clarity of the generic strategies concept and its applicability to the situation in the region under discussion.

Next, a more in-depth review is performed of the resource-based view approach (3.2.2) and the competence approach, which seem to propose a comprehensive set of overlapping findings concerning the nature of competitive advantage and can serve as the basis for constructing the competitiveness dimension of the research model. Although this approach is

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<sup>48</sup> An on-line search of one of the most popular databases in this field resulted in more than 3500 matches for the phrase “competitive advantage” and its immediate derivatives, and more than 4500 matches for “strategic change management” and its derivatives.

significantly more popular with academics than practitioners, the considerations it presents are basic to understanding competitiveness and are also highly applicable in the observed context.

The review of strategic change management starts with a brief overview of the most common, but sometimes confusingly imprecise, terminology and the development of the underlying schools of thought. It continues with a more thorough examination of the adaptation (contingency and learning), institutional, and evolutionary approaches to change management. Then a summary of integrative approaches, with context, content and process dimensions, is presented, and a comparison made between several widely-cited models of change management with a focus on those aspiring towards practical application. The role of leadership and culture in strategic change management is discussed in more detail, with an overview of leadership intervention as proposed in various models; also the influence of national and organizational culture on change, and the effects of change on individuals. The literature review concludes with a brief visit to the field of turnaround management. As opposed to the competitiveness area, where two schools of thought were given clear precedence over the others, the area of strategic change management appears to be much more fragmented and the literature review did not focus on any particular theory. Of somewhat greater applicability to the region was inertia theory (3.3.1) and Pettigrew's work on integrative models of strategic change (3.3.2, [Pettigrew 1987]). Among many process-oriented models more attention is given to Lewin [1947], Tichy [1983b] and Kotter [1995], while the work of Kotter and Schlesinger [1979] marks the area of the role of change agents.

Finally, based on the constructs identified in the first two parts of this chapter, a research model is presented which proposes an explanation for the ongoing transformation process on the company level in Croatia and Slovenia, which is later to be verified through the qualitative research presented in Chapter 5.

Throughout the text I have made explicit references to what I find particularly relevant when applying a given theory to countries in transition. These comments link the literature review with the general observations made in Chapter 2. Their purpose is to clarify a possible interpretation of the conclusions from the literature review within the research context, and to point out those conclusions which will be used to build the research model.

### **3.1 The concept of competitive advantage: a general overview of the literature**

Although their definition of the term *competitive advantage* may differ in wording, most authors agree on the (almost tautological) essence of the significance of its presence (or absence) for the firm: a firm must have competitive advantage over its rivals (in the marketplace) if it wishes to ensure above-average performance<sup>49</sup> over a certain period of time. In other words, competitive advantage is seen as a necessary (but not sufficient, some scholars note) prerequisite for above-average performance [Porter 1985, Coyne 1985, Barney 1991].

The concept of competitive advantage has its roots in economics, where researchers created many theories to explain the possible sources of economic rent [Ricardo 1966, Chamberlin 1933, Schumpeter 1934]. Since the 1980s the question of how firms achieve and sustain competitive advantage has become one of the explicitly fundamental issues in the field of strategic management [Rumelt et al. 1994]. While the importance of this topic seems to be a matter of general consensus among academics, many approaches developed over time in order

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<sup>49</sup> As will be discussed, the commonly-accepted performance measure of a firm is economic rent.



to answer the above question. Some resulted in an explicit *theory of the firm*<sup>50</sup>, while others were less ambitious in scope and restricted themselves to building partial models focused on explaining or prescribing elements of the firm's strategic behavior.

There is no prevailing taxonomy of strategy formation schools<sup>51</sup> or theories explaining competitive advantage, and even the most popular frameworks are often cited under slightly different names (e.g. resource-based theory [Conner 1991], resource-advantage theory [Hunt 1997] or resource-based view [Barney et al. 2001]<sup>52</sup>; industrial organization economics [Conner 1991] or organizational economics [Combs and Ketchen 1999]; environmental perspective [Barney 1991, Cockburn et al. 2000] or positioning school [Mintzberg and Lampel 1999]). Also, continuous efforts have been invested in bridging different approaches and developing a "unified" theory or integrative model (e.g. [Smith et al. 1996, Oliver 1997, Juga 1999, Combs and Ketchen 1999]), a situation which further blurs the borders between individual theories (or "views"). Finally, different authors use different criteria when classifying individual contributions within various frameworks, resulting in a confusing mix of terminology (e.g. work on learning organizations [Senge 1990] being discussed within the discipline of organizational learning [Miller 1996], classified as a major organizational capability within the dynamic capabilities view [Eisenhardt and Martin 2000], treated as a strategic resource in the resource-based theory [Smith et al. 1996, Michalisin et al. 1997], or defined as part of complexity logic [Lengnick-Hall and Wolff 1999]; the dynamic capabilities view is treated as a framework either different from the resource-based view [Teece et al. 1997] or forming part of it [Eisenhardt and Martin 2000, Barney et al. 2001]).

As noted above, industrial organization economics is one of the social sciences with the closest links to the contemporary concept of competitive advantage. For that reason I shall present a brief overview of several schools of thought developed within industrial organization economics which have influenced the subsequent development of the strategy schools from the 1980s onward. I shall follow this with an overview of another four theories of relevance for further discussion and research model building, while deliberately omitting many others (e.g. theory of complex adaptive systems, chaos theory, game theory). The main criteria for omission was that, based on a brief review, I found a particular theory less fit for formulating a coherent research model, relevant and applicable to firms in the region.

The various schools within industrial organization economics theory share an important assumption, which seems to be universally accepted by other schools of thought derived from economics, but not necessarily by those derived from other social sciences (e.g. the institutional theory). The assumption I refer to concerns the purpose of the firm, and it states that the ultimate purpose of the firm is to maximize profits [Conner 1991]. This is generally accepted as true despite some evidence [Scherer 1970, Pfeffer and Salanick 1978] that survival, rather than profit maximization, is the most common goal among organizations. The importance of this assumption for firms operating in economies in transition is even higher than for those in market economies, since for them it has meant a dramatic change: the goal of

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<sup>50</sup> Holmstrom and Tirole [1985] believe that a theory of the firm must address two central questions: why firms exist (their purpose), and what determines their scale and scope. Competitive advantage is clearly linked to both questions: a) above-average performance (regardless of the unit of measure taken for assessing performance, which depends on the particular theory) by definition means that the firm is successful in fulfilling its purpose, and b) competitive advantage *is ex-post-facto* one of the factors determining the firm's scale and scope.

<sup>51</sup> See Mintzberg and Lampel [1999] for an interesting attempt to systematize strategy formation schools and consolidate different approaches within a single framework.

<sup>52</sup> This implicitly points to a matter of academic debate – is resource-based view a distinct theory of the firm or not [Priem and Butler 2001]?

the firm changed overnight from fulfilling broader social goals (e.g. job security) to maximizing profits. Therefore it can be expected that management assumptions as to the purpose of the firm are an important element in context interpretation. They would, in turn, influence both perceptions about the need for change as well as decisions related to the design of the change effort. If profit maximization were seen as the main goal, one would expect to see more radical measures taken within the change effort to secure profits. On the other hand, if broader social goals still dominated because of institutional inertia, one would expect to see less radical measures, especially in terms of employment reduction as part of cost-cutting. The employment level in most countries in the region in the period from 1991 to 1995 fell significantly more slowly than did the volume of economic activity. This indicates that this important hypothesis concerning the purpose of the firm and its influence on the managerial response to change deserves to be tested through empirical research.

While united around the assumption of profit maximization as the ultimate purpose and thus a simple measure of firm performance<sup>53</sup>, various schools of thought within industrial organization economics strongly disagree about which factors affect firm performance the most. The definition of these factors is the key attribute differentiating one school from another.

### 3.1.1 Neoclassical perfect competition theory

*Neoclassical Perfect Competition Theory* [Stigler 1957, Stigler 1968, McNulty 1968, Alchian and Demsetz 1972] assumes that the main role of the firm is to efficiently combine resources (labor and capital) to produce outputs. Inputs are readily available and all resources are perfectly mobile. Since all parties have perfect and complete information (including information on the marginal contribution of each unit of input), resources flow towards the firm where they can be used to create the highest value (i.e. the firm which has the best input – output conversion factor and associated cost curve). While this approach is of interest to economists, due to its simplification (single product units, perfect information) it is of limited relevance to practitioners and will not be further reviewed in this text.

### 3.1.2 Monopoly theory

*Monopoly Theory*<sup>54</sup> [Bain 1948, Bain 1950, Scherer 1970, Weiss 1975] takes the view that firms try to limit their productive outputs because of the monopoly they have established or through collusion with rivals, thus raising the price level above that which would exist in ideal market conditions. This allows firms to achieve higher economic rents. The monopoly theory claims that the industry structure, e.g. concentration of competitors and markets, degree of vertical integration, entry barriers, or industry-specific cost structure patterns, determines the behavior of rivals (e.g. pricing), which in turn determines the economic performance of participating firms (the so-called *structure – conduct – performance paradigm*).

It is interesting to note that such behavior is often related to the relative size of the company, logically associated with its potential to exercise monopoly or to be a potentially valuable contributor in an oligopoly [Mann 1966, Gale 1972, Shepherd 1972, Weiss 1975]. The major limitation to a firm's growth is found primarily in external factors: government antitrust intervention, and the oligopoly tendency to preserve the status quo. As opposed to perfect

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<sup>53</sup> In consequence, ROA, ROE and EVA are the most widely accepted firm performance measures in contemporary research methodology.

<sup>54</sup> This theory is also referred to as "Bain-type", after J. S. Bain, one of its main contributors.

competition theory, monopoly theory predicts the long-term heterogeneity of firm performance in an industry as well as across industries.

A number of influential economists have criticized several key aspects of monopoly theory [Galbraith 1954, Heflebower 1954, Clark 1955, Penrose 1955, Mason 1957]. They claim that it does not take into account the influence of the firm's internal structure and resources on its behavior, and that these must not be ignored (this was one of the sources of the later development of the resource-based view). Particularly interesting is the concept of *market position* [Heflebower 1954], which linked the firm's internal resource structure and its competitive position in the market. Also, these writers object to collusion as the principle element of inter-firm behavior, and emphasize the notion of strategic action and reaction by rival firms (e.g. in pricing policies). They also state that buyers and suppliers develop power to effectively counter monopolies. Finally, they claim that a firm's growth is not regulated by monopoly / oligopoly considerations, but by other factors, such as opportunities for efficient use of productive resources.

The theoretical underpinnings and conclusions as to the influence of industry concentration and a firm's market share on its profitability, although seriously questioned and only weakly confirmed by empirical research within monopoly theory [Scherer 1970, Weiss 1975], have nevertheless proven very influential not only within academic circles but also among practitioners and governments. They are closely associated with the ideas driving PIMS<sup>55</sup> research [Buzzell and Gale 1987], which has had an enormous influence on the strategic behavior of companies since the publication of its results. On the other hand, some elements of monopoly theory related to industry structure are also clearly present in the environmental school of thought, as discussed below. Also, the links between the relative size and performance of the firm continue to be interesting in this period of intense globalization and massive levels of M&A activity, leading to increased levels of industry concentration<sup>56</sup>, as noted by most prominent scholars. This has been acknowledged by governments – a continuous focus on updating and strict enforcement of antitrust legislation is a traditional feature of the US government agenda (the legal case against Microsoft is a good example), and the antitrust concern has recently made its way to Brussels, despite the evident strong opposition of member countries which allow monopoly practices where they see benefits for the national interest.

Finally, one of the clear possible applications of this school of thought is to the situation in countries in transition before the changes, when markets were dominated by monopolies or oligopolies. In the majority of these countries this was due to state intervention, typically in the form of central planning. In former Yugoslavia, however, the cause was not direct state intervention, but the lack of antitrust legislation and practices, which allowed rival firms to maximize profits via collusion. Thus, the behavior of firms to a large degree fulfilled the predictions of monopoly theory: even after the formal opening of the market, in the absence of effective government antitrust policies companies in a position to establish effective oligopolies continue their efforts to maximize the economic rent from that source, and had no

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<sup>55</sup> The PIMS (Profit Impact of Market Strategy) database was the result of a 15-year quantitative study of more than 3,000 business units. The research group interpreted the results as showing the positive and strong relationship between market share and performance, although these findings were empirically questioned and reinterpreted in significantly different ways by some other scholars [Baden-Fuller and Stopford 1992].

<sup>56</sup> Although found in most of the literature describing current trends in industry structures and management priorities, the statement on increased level of concentration should not be taken at face value. There is some empirical evidence that the concentration in some major industries, such as the car industry, following the consolidation stage in the first half of the 20<sup>th</sup> century actually decreased after 1980.

incentive to organize themselves for true market competition<sup>57</sup>. In terms of the research model, this theory would imply that in interpreting the context and designing their firm's response to it managers would try to maximize the benefits and duration of the monopolistic position. As will be shown later, this is in line with the predictions of resource-based theory, where monopolistic position is seen as one potential resource.

### 3.1.3 Schumpeter's theory

The key element of *Schumpeter's Theory* is a focus on innovation as the means by which a firm can exploit existing and future market opportunities. It thus involves a dynamic view of industries, as opposed to the predominantly static ("equilibrium") character of both the perfect competition and monopoly theories. It also takes a different view on the use of the monopoly position, claiming it to be a welcome precondition for innovation since it allows for financial balance in the inherently risky process of innovation [Schumpeter 1942]. In terms of research, the major focus is on the relationship between innovation and industry / market structure, as well as between firm size and innovation [Scherer 1970, Kamien and Schwartz 1982].

Schumpeter's dynamic view of entrepreneurial opportunities and the need for innovation doubtlessly presents an important cornerstone in the body of economic theory. However, I shall not specifically discuss its practical applications, but shall treat them within the discussion of value creation strategies as related to dynamic capabilities.

### 3.1.4 The Chicago school view

The *Chicago School* of thought [Stigler 1966, Stigler 1968, Demsetz 1968, Demsetz 1973] is based on the view of the firm's primary role in enhancing efficiency in production and distribution. In contrast to the monopoly theory, it strongly advocates the efficacy of market mechanisms and the strict application of price theory. The scholars belonging to this school have concluded that effective collusion is unlikely due to the high cost of monitoring and enforcement, and thus that the above-average returns observed must have other explanations, primarily related to the firm's capability to outperform its rivals in efficiency in production and distribution. They have also made the realistic assumption that information has a cost, here undermining the basic assumption of perfect competition theory. Also, they have attributed some aspects of firm behavior which within monopoly theory are described as monopolistic (e. g., advertising, or vertical integration) to a striving towards higher efficiency.

Another interesting implication of the Chicago school view is the explanation that the firm's growth is limited strictly by the efficiency gains (or losses) which growth produces. This is directly linked to the way resources are acquired and used (e.g. economies of scale and costs of coordination). Also, in this view the value of entry barriers is limited by the ability of new entrants to eliminate the efficiency advantage of the incumbents.

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<sup>57</sup> Although more evidence on individual firm behavior will be provided in Chapter 5, it would be interesting to perform a more comprehensive study of the banking sector in Croatia and Slovenia. Despite privatization and the entry of international competitors (both in the form of green-field operations and through purchasing of local banks) there was no clear sign of an increase in competitive behavior (e.g. significant productivity improvements or major changes in product pricing). As a matter of fact, the Slovenian government in the late 1990s allowed overt collusion within the Slovenian Bank Association in setting spreads and minimum interest rates. Also, in some cases MNCs considering investment in a local company tried to achieve a government-supported monopolistic position as a precondition for investment.

As regards the application of Chicago school views to the situation in countries in transition, it closely approaches the official standpoint of some international institutions, most notably that of the International Monetary Fund. This brings us back to my comments in Chapter 2 regarding IMF policy in these countries: although one may agree with the views on market mechanisms forwarded by the Chicago school, the insistence on full reliance solely on these mechanisms has created considerable controversy and, it is very likely, also some damage, as described by Hanke and Walters [1993].

### 3.1.5 Transaction cost economics theory

*Transaction Cost Economics Theory* is based on the assumption of an opportunistic attitude and behavior on the part of firms which tries to avoid the transaction costs incurred through external contracts [Coase 1937, Williamson 1975, Williamson 1985]. The firm exercises (hierarchical) control in order to internally suppress human opportunism, which put it in a superior position as compared with markets, which have no such mechanisms for combating opportunistic behavior.

Transaction cost economics has had a major influence both on academic research and the behavior of practitioners. Among areas covered have been optimal financial structure [Balakrishnan and Fox 1993], design of internal incentive systems [Hoskisson and Hitt 1988], distribution strategies [John and Weitz 1988], international expansion [Rugman 1981, Teece 1983], strategic alliances [Balakrishnan and Koza 1993], and vertical integration [Walker 1988, Masten et al. 1989], to name a few.

While achieving obvious popularity, transaction cost economics has also attracted significant criticism, even from the originator of the theory, who argued that the later development of the theory focused too much on the firm as the purchaser of factors of production and neglected the running of the business as its main activity [Coase 1988]. Other critics objected to its overly ideological approach [Perrow 1986], lack of touch with reality [Simon 1991] and over-dependence on generalized assumptions concerning the opportunistic character of human nature and the efficiency of proposed control mechanisms [Ghoshal and Moran 1996].

Here let me consider some of the arguments presented by Ghoshal and Moran [1996], which I find to be valid in principle (for which reason some postulates of transaction cost economics are worth considering in countries in transition), but which deserve additional comment when applied to the situation in these countries.

Ghoshal and Moran began their article with a joke about two hikers woken by a tiger. One reached for his running shoes, apparently betting his life on his ability to outrun his partner. The authors used the joke to point out the need to understand and assess underlying assumptions, which, they claim, are wrong both in the joke (running is not the smartest way out of that particular situation) and for transaction cost economics theory (hierarchical control is not the best way to deal with opportunism).

One of the most popular jokes in Croatia aiming at the narrow views of economics goes like this: an American tourist sees a young man sitting idle on the bench next to the sea. He approaches him and suggests that he start fishing, instead of being idle. "Why should I do that?", young man answered. "To earn some money." "And?" "Buy a boat, fish more, get more money, buy more, get rich, be able to sit and enjoy life", the argument goes. "Well, that's what I am doing now!", is the young man's final argument. The assumption not discussed is how the young man can afford to sit idle on the bench, i.e. what does he live on,

if he's doing nothing? The point goes beyond this particular joke, however good or bad, and touches behavior developed during socialism times in former Yugoslavia (and other countries in transition). It is also reflected in the famous quote "They can't give me as low a salary as the little I can work" (assuming that in one way or another the person's everyday needs will be taken care of regardless).

Opportunistic behavior of the kind implied by the joke and the quote did become quite a pronounced part of everyday life in the region's firms. As noted by Ghoshal and Moran, findings from dissonance theory [e.g. Aronson 1980] suggest that opportunistic behavior fosters opportunistic attitudes. Given the environmental conditions prior to the change in countries in transition, a significant level of both opportunistic behavior and opportunistic attitudes existed in firms there.

Further, the model of "the cycle of self-fulfilling prophecy" presented by Ghoshal and Moran implies a self-explanatory statement that the benefits from opportunistic behavior related to transaction characteristics have a positive influence on it. While this is true as such for any economic environment, that of the countries in transition offered unusually substantial benefits as compared with developed markets (which is for at least two reasons true for all situations of economic discontinuity: market regulation mechanisms do not function, and economic rent tends to be generated from innovation, rather than efficiency [Hoskisson et al. 2000]). In consequence, it was natural that a significant reinforcement of opportunistic behavior in expectation of reward existed in the first period after the changes in countries in transition. In terms of its implications for the research model, this articulates the need to investigate the motives for change: how was the environment perceived, and what were the criteria for deciding between the advantages and disadvantages of starting a change process?

I find the most intriguing proposition of Ghoshal and Moran to be the notion of the superiority of social control (e.g. through the "feeling for the entity") to hierarchical control, the first hindering opportunistic behavior and the second actually reinforcing it [Ouchi 1980, Wilkins and Ouchi 1983, Eagly and Chaiken 1992, Enzle and Anderson 1993]. This should be put into the perspective of the need for control-context fit, i.e. the finding that "certain kinds of control mechanisms are more appropriate than others for certain kinds of businesses and activities" [Ouchi 1979, Eisenhardt 1985, Ghoshal and Moran 1996]. Ghoshal and Moran refer to Ouchi [1979] and suggest: "(w)hen performance can be measured accurately, based on either the behavior of the individuals or on the outcomes from those behaviors, rational controls are effective. When, however, neither behavior nor outcomes can be measured precisely, rational control loses its efficacy, and social controls become preferable." It is important to notice that Ghoshal and Moran do not provide an explanation for their use of the term *rational control*, but from the context it can be assumed that the term *is not* identical with the term *hierarchical control*, since the latter was used strictly to reinforce the impact on opportunistic behavior, while the above wording allows that under certain circumstances rational control can have an attenuating impact.

The hidden underlying assumption of the above argument is that social control is aligned with firm goals and does not approve of opportunistic behavior. However, as already presented, strong arguments exist in favor of the opposite assumption, that this was not the case for firms in the first period after the changes in the countries in transition. Thus, I assume that given the misalignment between firm goals and social control, rational control had to be established in the first period after changes. Therefore, achieving transparency of performance on the level of firms and individuals was of the highest priority. The consequence of this for the research

model is the need to test whether or not establishing performance transparency and internal control systems were a priority among leadership interventions.

A significant part of transaction cost economics theory concerns agency theory, which states that managers (as agents) are expected to comply with the interests of external owners of private enterprises, but it is difficult for these owners to ensure that managers do comply in reality [Williamson 1985]. Asymmetry of information between managers and external (especially diffused) investors increases monitoring costs, and allows managers to pursue their own goals. In countries in transition this factor is often augmented by the strong motivation towards opportunistic behavior, as well as the difficulties in assessing information and the associated high transaction costs [Wright et al. 1998].

While this also points in the direction of the above conclusion related to rational control mechanisms and transparency of performance, it is worth looking more closely at the application of agency theory in countries in transition. I find valid several arguments which change the perspective agency theory takes in other environments. The first is related to the moral hazard, which is assumed to have negative effects on the firm. In countries in transition this is not necessarily true. Although managers might not be under sufficient outside control (as predicted by agency theory), motivation based on self-interest may in many cases be under strict peer control, and it may also be aligned with the well-being of the company [Earle and Rose 1996]. Also, the concept of efficiency of outside control is highly problematic in countries in transition for at least two reasons. On the one hand, outside control is a novel concept for the region, and thus external supervisors in most cases lack experience and knowledge [Brom and Orenstein 1994, Blasi et al. 1997]. On the other hand, external controllers are no more likely to act in the public interest than are internal managers, especially when privatization patterns drive them towards collusion [Amsden et al. 1994]. This concurs with the finding that supervisory board structure does not correlate with firm performance [Prašnikar et al. 2000], as well as with the failure of empirical research to find a link between privatization and change of management behavior [Whitley and Czaban 1998]. In terms of implications for the research model, this confirms the conclusion that the focus of leadership intervention is on creating internal (rather than external) control systems.

### 3.1.6 Organizational ecology

Although *Organizational Ecology Theory* can be clearly linked with the influential article of Hannan and Freeman [1977] and their successive work [Hannan and Freeman 1989], it is also closely linked with the work of few other scholars who have used evolutionary logic to formulate their key proposals [Mintzberg 1978, Quinn 1980]<sup>58</sup>. The theory makes a parallel between the evolutionary framework of variation, selection and retention of species and organizations as social and cultural systems [Alchian 1950, Campbell 1969, Nelson and Winter 1982]. Burgelman [1994] used the theory in his empirical study of the semiconductor industry as a highly dynamic environment, thus proving that organizational ecology can be a practically applicable framework for strategy research.

The core belief of the organizational ecologist is the notion that individual firms cannot shape developments in the industry. Firms are subject to selection on the basis of variety and those most suitable to the environment survive. Since the rules of the game within industry are defined outside of the scope of the influence of any firm, the latter have very limited room to manoeuvre. Hannan and Freeman [1977] suggested that a firm can preserve the capability of

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<sup>58</sup> An excellent overview of the organizational ecology literature can be found in [Carroll and Hannan 1995].

surviving change by maintaining organizational slack, but chance plays a crucial role on the level of industry, since some firms will have the luck to fit into a changed environment and will thus be selected for survival by external factors. Other authors, however, claim that firms have some proactive adaptive capacity [Nelson and Winter 1982, Baum and Singh 1994], primarily through leadership interventions which define the strategic intent of the firm and focus on the development of human and social capital [Lovas and Ghoshal 2000]<sup>59</sup>.

A more detailed consideration of the notion of specialization and slack makes for a truly important implication of organizational ecology theory for companies going through the two-phase process of change in countries in transition. As opposed to most theories derived from the economic thinking which treats slack as inefficient use of resources, therefore implying that it should be minimized in order to maximize the economic rents, organizational ecology treats slack as a potentially positive element, helping companies to survive in situations of (especially discontinuous) change. This difference in views deserves empirical verification, since it may dramatically influence the survival rate of firms facing major changes. As regards the research questions, it means that they should investigate how the firms observed used slack, both in terms of its size and importance for the change process and as related to leadership interventions such as resource allocation.

### 3.1.7 Institutional theory

*Institutional Theory* counters the key assumption of industrial organization economics theory that the motives for human behavior can be explained by rationale of economic rent optimization. Institutional theory proposes that firms operate within a social network of norms, values and underlying assumptions about what constitutes appropriate or acceptable economic behavior [Meyer and Rowan 1977, DiMaggio and Powell 1983]. Their role is to reduce both transaction and information costs through reducing uncertainty and establishing a stable structure that facilitates interaction [North 1990]. Further, this view suggests that the motives of human behavior should be extended beyond economic optimization to social justification and social obligation [Zukin and DiMaggio 1990, Scott 1995]. Firms are rewarded for conforming with social expectations through increased legitimacy, better access to resources and increased survival capabilities [Scott 1987, Baum and Oliver 1991]. In consequence, pressures towards industry isomorphism are strong [DiMaggio and Powell 1983].

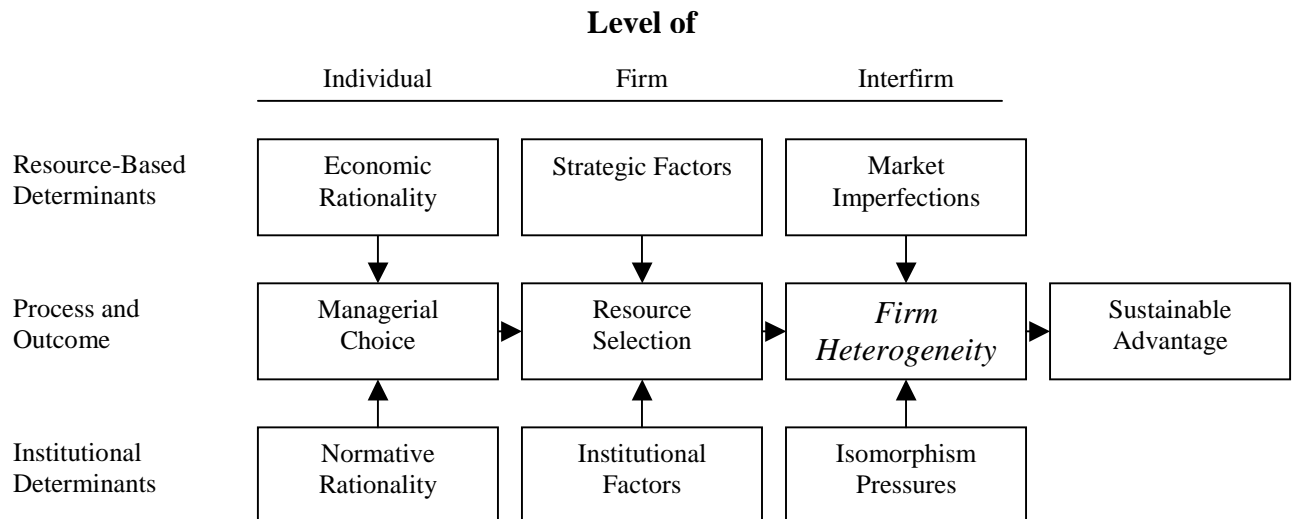
On the level of behavior within a firm, institutional theory suggests that existing culture and power structure support existing routines so strongly that it is very difficult to change them. Thus this view argues in favor of a very high level of organizational inertia. Obviously, organizational change (transformation) is the very focus of institutional theory, which thus bridges the fields of sustainable competitive advantage and organizational change. Oliver [1997] proposed a simple model describing the potential combination of institutional and resource-based views, illustrated in Fig. 3.1. This model is based on the assumption that the sustainable advantage of a firm's heterogeneity is the result of managerial choices in resource selection. In that respect, Oliver stays close to the resource-based view, from which the model also takes key factors influencing managerial choices, resource selection and firm heterogeneity. However, the model is extended to include predictions of institutional theory

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<sup>59</sup> The development of human and social capital through leadership intervention in order to prepare the company for a new stage of evolutionary selection, as proposed by Lovas and Ghoshal [2000], brings organizational ecology theory closer to some aspects of the resource-based view. The principle difference remains, though, in a fundamentally different explanation of the underlying nature of forces influencing the firm and their meaning for its capability to change.



claiming that both groups of factors have a significant influence on the outcome, i.e. the sustainable advantage. I find this approach particularly suitable for the analysis of firm and individual behavior in countries of transition [Shenkar and von Glinow 1994, Clague 1997, Hoskisson et al. 2000], and I suggest that both institutional determinants and resource-based determinants as defined by Oliver [1997] played an important role in the observed change. In consequence, the research model should include both groups of determinants and verify their presence during change.



Source: Oliver [1997]

Figure 3.1 Sustainable advantage: determinants of the process

One particularly interesting implication of institutional theory for countries in transition is the place of management in the network (or hierarchy) of institutions. As described in Chapter 2, even in former Yugoslavia, which was among current countries in transition the most advanced in terms of application of market mechanisms, the managerial profession did not exist in the true sense, since managers were seen as “appointees” supported by social and political, rather than economic stakeholders. With the fundamental institutional changes management was re-institutionalized, and acquisition of appropriate managerial (professional) competence [Soulsby and Clark 1996] received great attention. In practical terms, those in managerial positions at the beginning of the changes had to obtain support from other stakeholder groups, or their institutional links would lose importance over time, which, assuming the importance of institutional determinants, would negatively influence their performance. Thus, research should question the conclusion that management saw the maintenance of institutional links as a key priority.

### 3.1.8 Environmental school

The *Environmental School* (many authors, including Porter [Porter 1995] refer to it as the *Positioning School*<sup>60</sup>) made a significant shift from research into the sources of competitive advantage which dominated the period from the mid-1960s to the early 1980s, and which suggested that firms obtain competitive advantage by implementing strategies that avoid their

<sup>60</sup> Some authors make a distinction between the environmental and positioning schools [e.g. Mintzberg and Lampel 1999]. Since I find it of secondary importance to my review, I shall refer to both terms as having the same meaning, and denoting the school of thought best represented by the work of Michael Porter.

internal weaknesses and use their internal strengths to exploit external opportunities and neutralize external threats [Ansoff 1965, Andrews 1971, Hofer and Schendel 1978]. Building on insights from industrial organization economics, Porter [1980, 1985] suggested that strategy should be built on the basis of structural analysis of the industry, thus shifting the focus of strategy research outward, toward the analysis of the firm's microeconomic environment. His work became instantly popular with practitioners, since it proposed simple analytical tools that seemed to offer managers the previously-lacking advantage of "making the right strategic choices"<sup>61</sup>.

One of the key tools used by the positioning school is the *five-forces* structural industry analysis, based on assumptions about the determinants of industry attractiveness [Porter 1980]. It includes analysis of the threat of new entrants (based on an understanding of entry and exit barriers), the threat of substitute products, the bargaining power of suppliers, the bargaining power of buyers, and the intensity of rivalry among existing competitors. The concept itself has several interesting implications. One is that some industries are inherently more attractive (i.e. offer higher returns) than others. This notion has proved to be extremely influential, leading to further refinement of portfolio analysis tools and to significant diversification activities.

The other notion which is a direct result of the positioning perspective concerns the key leadership function that managers must carry out within the company: to understand a structural analysis and, based on it, make choices about competing in a certain industry. As mentioned above, this implies that having the right kind of industry-related information and using it properly can generate an advantage over competitors [Shapiro and Varian 1998]. This also argues against bottom-up change, since empowered operational managers "often lack the vision of the whole and the perspective to recognize trade-offs" [Porter 1996].

Another influential assumption behind the positioning school is the perfect mobility of resources among competitors in the industry [Scherer 1970, Porter 1981, Barney 1986a]. In consequence, any advantage built on access to company-specific resources would be merely temporary, and in the long term firms choosing the same position within any given industry<sup>62</sup> should demonstrate homogeneous performance, leading to competitive convergence [Barney 1991, Porter 1996]. As discussed later, this is probably the most controversial assumption of the positioning school, drawing significant critique and fueling other directions of research such as the resource-based view.

The positioning school did not only offer the analytical tool for looking at industry structure, but also proposed possible generic strategies to be followed (or strategic positions to be taken, depending on the interpretation of the dynamism) [Porter 1985]. While Porter initially proposed three generic strategies – cost leadership, differentiation and focus (which could be cost focus or differentiation focus, but Porter treats it as one strategy) – many authors, when speaking about competitive advantage, reduce this to two options, cost or value differentiation. This reduction is exemplified in one of the most popular strategic positioning tools, the High Perceived Value (HPV) – Low Delivered Cost (LDC) diagram.

The concept of cost leadership, as Porter presented it [Porter 1985], implies the existence of "*the low-cost producer*" (italics in original) in an industry, i.e. one company having a cost

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<sup>61</sup> However, Cockburn et al. [2000] suggest that there is no research-based quantitative evidence to confirm any advantage gained by managers who have used these analytical tools versus those who have not.

<sup>62</sup> Clusters of such firms are often referred to as "strategic groups" [Porter 1980].

advantage over others. In order to turn that advantage into above-average returns, the cost leader should “achieve parity or proximity in the bases of differentiation relative to its competitors” [Porter 1985]. This definition seems to be very vague, since it does not define more precisely which competitors should be taken as reference group (e.g. those from the same strategic group, the industry average, etc.). Nevertheless, it implies that, while the company strives to achieve competitive advantage along one dimension, it cannot neglect all the other dimensions but must reach a certain “qualifying level” along each of them.

An important consequence of the idea of only two bases of competitive advantage is the notion of companies who are *stuck in the middle* [Porter 1985], because they are not effectively pursuing either of the positions. Porter suggests that this position leads to below-average returns and, eventually, demise. He also suggests that companies trying to pursue cost and differentiation positions simultaneously will be successful only if they do so in different and well-separated organizational units, or if three conditions are met: competitors are stuck in the middle, cost is strongly affected by share or interrelationships, and the firm pioneers a major innovation [Porter 1985].

Finally, Porter also suggested that the best way to look at the firm’s ability to successfully implement a chosen strategy of creating and sustaining competitive advantage is through its value chain (the discrete activities it performs). The activity-based view of the firm is complemented by the notion of strategic fit among its activities, which can be on different orders of magnitude with the resulting corresponding levels of competitive advantage [Porter 1996]<sup>63</sup>. Porter and many other authors explored various activities as possible sources of either cost leadership or differentiation competitive advantage [Day and Wensley 1988]. It should be noted that this particular line of research often crossed the line between the environmental school and other schools of thought (in particular the resource-based view).

Some of the main criticism of the environmental school is similar to the criticism of most “classical”, structurally-oriented frameworks: that it lacks dynamic perspective [Mintzberg and Waters 1985], that it wrongly assumes high resource mobility [Barney 1991], that it has little empirical justification [Wright 1987] and that it ignores the implementation side of strategy [Cockburn et al. 2000]. Despite all criticism, the school has had a great, lasting influence both on scholars and (even more so) on practitioners.

This influence is also to large degree present in countries in transition, where the first generation of professional managers immediately after the start of reforms mostly adopted as useful the tools proposed by the positioning school. The later spread of MBA-type education and intervention by international consulting companies only added to their popularity. As a result, many companies began to perceive the need for clear positioning on the HPV-LDC diagram. As mentioned earlier, this coincided with growing competitive pressures from global, regional and local competitors. However, the process was also influenced by the prior experience of the firm, which could benefit from diversified activities leading to increased probability that performance risks were balanced across the portfolio. Many managers found it difficult to accept not so much the need for clear positioning, but the consequences it had on portfolio reduction and associated increase in risk.

Based on predictions in the literature, one would expect companies to decide between either aiming at a low-cost or a high-perceived-value position, since the theory implies that “stuck in

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<sup>63</sup> The concept of strategic fit is an old one in the strategy literature [Van de Ven 1979, Venkatraman and Camillus 1984, Venkatraman 1989], and originated from the population ecology model [Aldrich 1979].

the middle” positions lead to unsatisfactory performance and the economic decline of the firm. The position taken would be influenced by the way the management perceived the situation in the industry and the markets. As a corollary to this conclusion, the management would focus its interventions on establishing the desired position.

Further application of the same logic implies that a management decision on taking the low-cost or high-perceived-value position would be based on a number of criteria related to its perceptions of the industry and markets, which also indirectly involves perceptions of the political, social and economic environment. Obvious criteria include an estimate of feasibility in terms of timing, as well the needed resources. Both criteria point to the next conclusion: the response of the management will depend on whether it perceives the situation in the industry and the markets as requiring immediate or long-term reaction, as well as on the assessment of the resources needed to achieve a low-cost or high-perceived-value position. I shall analyze the second criterion once again within the discussion of the resource-based view, to determine whether the low-cost and high-perceived-value positions were equally valid alternatives in all circumstances.

### **3.2 The resource-based view, core competence and dynamic capabilities**

Although the seminal articles on the *resource-based view* [Wernerfelt 1984, Dierickx and Cool 1989, Barney 1991], on the one hand, and *core competence* [Prahalad and Hamel 1990] and *dynamic capabilities* [Teece et al. 1997] on the other did not attempt to create an explicit link between the two, such a link was later clearly established [Lengnick-Hall and Wolff 1999, Eisenhardt and Martin 2000, Barney et al. 2001]. With this in mind, in this chapter I will review the literature from all of the areas mentioned and, although each concept is presented in its own right, it is sometimes difficult to isolate the discussion in one individual framework.

#### **3.2.1 Main concepts of the resource-based view**

The concept of resources as the cornerstone of company competitive advantage is based on the old concept of economic rents generated by firm-level efficiency advantages which once dominated strategy literature in the form of a focus on corporate strengths and weaknesses [Penrose 1958, Ansoff 1965, Uytendaele et al. 1973, Hofer and Schendel 1978]. One particular cluster of literature within this approach explicitly emphasized firm-specific assets and capabilities as well as the mechanisms which limit their mobility as key determinants of firm performance [Penrose 1958, Rumelt 1984, Teece 1984], and can rightly be identified as preceding the contemporary resource-based view.

Starting from the structure-conduct-performance concept of environmental and monopoly theories as presented in the previous chapter, the resource-based view tackles two key assumptions of the environmental school: the concept of the homogeneity of firms within an industry (or a strategic group) [Scherer 1970, Porter 1981, Rumelt 1984], and the idea of high mobility of resources, which can be bought in factor markets [Hirshleifer 1980, Barney 1986a]. The resource-based view replaces these assumptions with their opposites: a) firms within an industry (or group) may be heterogeneous with respect to the strategic resources they own or control, and b) resources may not be perfectly mobile across firms, and thus heterogeneity can be long-lasting [Barney 1991, Peteraf 1993].

Since the concept of firm resources is central to the resource-based view, it might be interesting to see how it was formulated in the early literature and to investigate one of its

serious critiques. Wernerfelt [1984] defines resources as “anything which could be thought of as a strength or weakness of a given firm”. Barney [1991] also provides an all-inclusive definition of resources, as “all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness [Daft 1983]”. However, Barney argued that sustainable competitive advantage derives only from those assets which are valuable, rare, imperfectly imitable, and not capable of substitution [Barney 1991].

Critics of the resource-based view [Priem and Butler 2001] find these definitions too broad, tautological in terms of value creation (i.e. that the substitution of definitions leads to a definition of the type “value is created if the firm has what is needed to create value”) and difficult to measure and manipulate. As a practical consequence of such broadness, subsequent research looked at the incredibly wide area of possible sources of competitive advantage, conveniently labeling each as a “resource”: from intangibles such as social responsibility [Litz 1996], culture [Fiol 1991], and human resource competencies [Lado and Wilson 1994], to processes like new product development [Leonard-Barton 1992, Kusunoki et al. 1998], strategic human resource management [Wright et al. 2001] and manufacturing [Schroeder et al. 2002], or tangible assets such as information technology [Powell and Dent-Micaleff 1997].

Another implication of the broadness inherent in the resource-based view is the willingness of many scholars to use it in researching many different topics. As seen in Table 3.1, the range of topics is truly impressive and implies that scholars have used the resource-based view as a theory valid in different contexts and applicable to almost all aspects of firm and interfirm behavior<sup>64</sup>. It is also clear from looking at the list of titles that quite a few authors deal with several topics in the same text, making the division and attributions presented in Table 3.1 somewhat artificial.

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<sup>64</sup> Priem and Butler [2001] state that according to the taxonomy of research topics proposed by Shendel and Hofer [1979], literature belonging to the resource-based view can be found in 13 out of 18 topical areas.

| Research Topic <sup>65</sup>              | Representative Authors                                                                 |
|-------------------------------------------|----------------------------------------------------------------------------------------|
| Theory of the Firm                        | Barney [1996]<br>Conner [1991]<br>Conner and Prahalad [1996]                           |
| Culture                                   | Barney [1986b]<br>Fiol [1991]<br>Li et al. [2001]                                      |
| Organizational Behavior                   | Mosakowski [1998]<br>Mueller [1994]                                                    |
| Social Responsibility                     | Litz [1996]<br>Russo and Fouts [1997]<br>McWilliams and Siegel [2001]                  |
| Corporate Governance                      | Holmstrom and Kaplan [2001]<br>Mahoney [2001]<br>Short et al. [1999]<br>Coff [1999]    |
| Environmental Analysis                    | Miller and Shamsie [1996]                                                              |
| Strategy Formulation                      | Wernerfeldt [1984]<br>Black and Boal [1994]                                            |
| Strategy Implementation                   | Lado and Wilson [1994]                                                                 |
| Formal Planning Systems                   | Michalisin et al. [1997]                                                               |
| Strategic Control                         | Mata et al. [1995]                                                                     |
| International Strategic Management        | Moon [1997]<br>Collis [1991]                                                           |
| Emerging Economies                        | Hoskisson et al. [2000]<br>Jarvenpaa and Leidner [1998]                                |
| Strategic Alliances                       | Eisenhardt and Schoonhoven [1996]<br>Hitt et al. [2000]<br>Harrison et al. [2001]      |
| Mergers, Acquisitions and Diversification | Markides and Williamson [1996]<br>Ingran and Thompson [1995]<br>Harrison et al. [1991] |
| Entrepreneurship                          | Alvarez and Busenitz [2001]                                                            |
| Knowledge                                 | Spender and Grant [1996]<br>Argote and Ingram [2000]<br>Conner and Prahalad [1996]     |
| Growth and Adaptation                     | Pettus [2001]<br>McGee and Thomas [1994]<br>Iansiti and Clark [1994]                   |

Source: Adapted from Priem and Butler [2001], Barney et al. [2001]

Table 3.1 Research topics in strategic management involving the resource-based view

<sup>65</sup> Research topics presented in Table 3.1 only partially follow the taxonomy of Schendel and Hofer [1979].

### 3.2.2 Resources, capabilities and competence

Looking more closely at the nature of resources with the potential to create sustainable advantage (often called *strategic assets* [Dierickx and Cool 1989, Amit and Shoemaker 1993, Michalisin et al. 1997]), it is generally accepted that, with rare exceptions, tangible assets are likely to have significantly less potential than intangible assets<sup>66</sup>. The basic conceptual argument supporting this claim in resource-based-view literature relies on strategic resource characteristics as defined by Barney [1991]: tangible resources are easily imitated [Miller and Shamsie 1996] and in principle are less rare (because they can be bought in factor markets). A good example of is the use of financial resources [Pfeffer 1994], but it also applies to other tangible resources such as information technology [Barney 1991, Powell and Dent-Micaleff 1997], technology in general [Zahra and Covin 1993, Pfeffer 1994] or manufacturing plants [Schroeder et al. 2002]. All of these assets *can* have some potential for creating competitive advantage, but in order to make that sustainable a typical proposal is that tangible assets should be bundled with the associated intangible assets (e.g. the capability of deploying IT for use in business [Powell and Dent-Micaleff 1997], or the proprietary technological know-how related to the manufacturing process [Schroeder et al. 2002]).

A clarification of the terms “resources”, “capabilities” and “competence” might be appropriate at this point. Since the term “resource” is often used in its broader, inclusive meaning, the concept it covers is usually subdivided into physical and financial resources, human resources and related skills of individuals, as well as organizational resources such as reputation or culture [Barney 1997]. The latter is close to the notion of capabilities, which refers to a firm’s capacity to *deploy, coordinate and exploit* strategic resources, often in bundles [Stalk et al. 1992, Amit and Shoemaker 1993, Schendel 1994, Barney 1997]. Capabilities include complex firm attributes, which are also the most difficult to copy and can typically be bought only through the purchase of a firm as a whole<sup>67</sup>. The notion of *core competence* became hugely popular following publication of the article by Prahalad and Hamel [1990] in which the authors warn against the fallacies of unrelated diversification and suggest that firms do best of if they “stick to the knitting”, clearly understand what they do well (i. e., better than the competition) and build on this as their core competence. While Prahalad and Hamel stayed on the relatively broad level of attributes related to core competencies (value for the customer, applicability in a wide range of markets, difficult to imitate), it is easy to see how the concept of core competence in principle matches the concept of complex strategic resources, i.e. capabilities. For this reason some authors suggest using the term “capability” as a substitute for (core) “competence”, or limiting the use of the term “core competence” to discussions on diversification and corporate level strategy [Barney 1997].

There is an important side effect in the conceptual difference between resources in the narrow sense of the word, and capabilities as complex resources. These two classes of resource do not differ merely in the nature of their complexity, but also in the time dimension of accumulation<sup>68</sup> [Dierickx and Cool 1989, Barney and Hansen 1994, Collis and Montgomery 1995], as capabilities require significant time (typically measured in years) to develop. Also,

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<sup>66</sup> Exceptions do exist. Good examples might be the locations of retail stores, or wire access to homes owned by telephone and cable operators [Collins and Montgomery 1995]. It should be noted, however, that the value of such resources may be subject to fast deterioration, typically due to technology change (branch-less banks, Internet shopping, wireless communications), often caused by the focused efforts of new entrants to break the incumbents’ monopoly of strategic physical resources.

<sup>67</sup> The same is true for some non-tradable resources, such as reputation [Dierickx and Cool 1989].

<sup>68</sup> In economic theory this is referred to as “time compression diseconomies”.

while the theory assumes economic rationality in managerial choice of resources (although influenced by common cognitive biases, limitations and organizational inertia [Amit and Shoemaker 1993]) individual managers have little immediate control over capabilities and the pace of their development [Mahoney and Pandian 1992, Amit and Shoemaker 1993]. This, as will be discussed later, has a negative effect on the ability of companies in transition to respond to discontinuous change.

Resource imitation is one of the central issues addressed in the resource-based view. Referring to the earlier work of Dierickx and Cool [1989], Barney [1991] proposes that limits to imitation are found in dependency on unique historical conditions (path dependency), an unclear link between resources and performance (causal ambiguity), and social complexity of the resource. The imitation issue carries with it an interesting notion: can firms be successful if they imitate their competitors? While the resource-based view responds with a clear “no”, this is a point where the empirical evidence seems not fully supportive [Medcof 2000]<sup>69</sup>. Furthermore, there is a potential inconsistency between the theoretical claim dismissing imitation as a source of value (based on the notion that value can be derived only from heterogeneity) and two equally valid observations: path dependency and strategic clusters. If we accept the argument that historical development creates unique attributes within complex resources and is a source of casual ambiguity [Dierickx and Cool 1989, Barney 1991], in other words that complex resources are path-dependent, then imitation (especially of a complex resource), even if aimed at copying a certain resource, also produces results which are path-dependent and thus different from the original. Also, from empirical evidence it is clear that more firms can achieve above-average performance in an industry over time. Implicitly, this means that they may do so based on differentiation from other firms in the industry, rather than on differentiating from each other. Thus, imitation within such a cluster need not necessarily be futile.

Another important consideration emerging from the idea of imitation as a possible tool for competitiveness improvement is the perception of the time available for improvement. One might expect that imitation would be seen as more appropriate, or even as necessary, if the perceived available time is short, thus limiting the ability of the firm to improve through experiment and true innovation<sup>70</sup>.

For firms in countries in transition the question of imitation is of high importance. On the one hand, there has been strong institutional pressure to copy the “western model” of firm behavior as a superior one. On the other, there have been very strong resource-related incentives to imitate competitors from developed markets. At the time of change the firms in the region were, by and large, not competitive by global standards. Another important factor was the fact that even the best of them had very few free resources to invest in improving their competitiveness. Thus, based on literature predictions concerning imitation, one would expect these companies to use imitation as an effective tool for relatively fast improvement of their overall performance with the goal of arriving at competitive parity, which would in turn

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<sup>69</sup> Although Medcof produces convincing evidence that transnational companies successfully follow an imitation strategy in international technology research and technology transfer and do not dispose of international units with resources which have low value and are not unique, he does not discuss an important aspect: how and to what degree do international technology research and technology transfer contribute to the performance of these companies? If we take a multidimensional view of the factors contributing to performance, companies might optimize their use of resources by following an imitation strategy for factors which they choose to treat as “qualifying”, while retaining other factors which are unique compared to their competitors.

<sup>70</sup> This is consistent with the pattern of response to discontinuous change based on the resource-based view, as presented later.



allow them to use low-cost labor (using the terminology of the positioning school, companies could use imitation and low-cost labor to achieve a low-cost position) or some other major distinctive resource in order to achieve competitive advantage.

While scholars agree on the advantages of intangible resources in terms of mobility barriers and inimitability, they have made surprisingly little effort to systematically explore and classify the various groups of intangible assets. One such attempt by Hall [1992] was based solely on the opinions of UK company CEOs in different manufacturing and service industries. Although the survey lacks the empirical rigor linking the resources identified with company performance, its findings were interesting (and supported by additional research [Hall 1993]). A summary is presented in Table 3.2, with the most important resources (in the opinion of the CEOs surveyed) ranked as 1, and the least important as 13. In line with the predictions of the resource-based view, the CEOs consistently identified intangible resources as the key ones for the performance of their companies.

| Resources                     | 1987<br>Ranking | 1990<br>Ranking |
|-------------------------------|-----------------|-----------------|
| Company Reputation            | 1               | 1               |
| Product Reputation            | 2               | 2               |
| Employee Know-how             | 3               | 3               |
| Culture                       | 5               | 4               |
| Networks                      | 4               | 5               |
| Specialist Physical Resources | 6               | 6               |
| Databases                     | 10              | 7               |
| Supplier Know-how             | 7               | 8               |
| Distributor Know-how          | 8               | 9               |
| Public Knowledge              | 9               | 10              |
| Contacts                      | 11              | 11              |
| Intellectual Property Rights  | 13              | 12              |
| Trade Secrets                 | 12              | 13              |

Source: Adapted from Hall [1992]

Table 3.2 Resource rankings based on Hall's empirical findings

Miller and Shamsie [1996] went a step further and looked not only at tangible versus intangible resources, but also at the nature of intangible resources and their fit with the environment. Here they followed Amit and Shoemaker [1993], who suggested that the firm has to consider the contexts within which various kinds of resources will have the best influence on performance. This significant claim extended the resource-based view and brought it closer to the environmental school perspective, a fact which Miller and Shamsie [1996] recognized by explicitly referring to Porter's view of the link between resources and the environment [Porter 1991]<sup>71</sup>. Miller and Shamsie [1996] also addressed the tautological attribution of the concept of resources to "everything that performed well" [Black and Boal 1994] and tried to precisely identify the distinctive advantages of different types of resources. In their analysis of the performance of Hollywood film studios, Miller and Shamsie [1996] classified strategic resources by the source of inimitability and concluded that property-based resources (i.e. those protected by ownership, contracts or patents) were critical for

<sup>71</sup> This perspective is also close to the concept of strategic fit as advanced by a number of scholars [Venkatraman and Camillus 1984].

performance in periods of stability (predictability) in the environment, while knowledge-based resources (i.e. those that often take form of technical, creative, collaborative, and integrative skills and are hard to imitate because of causal ambiguity) create competitive advantage in uncertain environments. This is consistent with the findings of the survey done by Hall [1992], if one accepts its implicit assumption of great dynamism in UK industries in the observed period: the CEOs evaluated the value of property-based resources as low.

Some authors who have applied the above to emerging economies have come to the conclusion that, on the whole, it is also intangible assets which create competitive advantage in these countries, although such resources are not necessarily product-market based [Hoskisson et al. 2000]. Exceptions are firms competing in global markets of specific commodities, which can develop competitive advantage based on natural resources or low labor costs [Aulakh et al. 2000]. Given the structure of natural resources and comparative labor costs in Croatia and Slovenia, it is easy to conclude that firms from these two countries do not fall within the group defined by Aulakh et al. [2000]. However, Croatia and Slovenia did not, for historical reasons, have fully-developed factor markets in the first period after the initial change. As an example, their financial and labor markets were overly-regulated and had a level of development significantly below that assumed by resource-based view theorists<sup>72</sup>. The conclusions from the literature imply that Croatian and Slovenian firms could in the first period of changes have relied on some tangible or less complex intangible assets, while that would have become more difficult as time progressed.

This concurs with the central conclusion derived from the literature review. If a firm has to decide about resources that could contribute to its competitiveness, it does so based on perceptions of the firm's existing and potential resources. The critical factors influencing the firm's decision are the time perceived as available for the transformation of existing resources into new ones, and the perceived likelihood of such transformation. If the perceived time is short, the firm is likely to try to build future competitiveness based on a set of resources which is very close to the existing set (and) or includes additional resources which can be acquired or developed under time constraints. If the firm has limited resources available for acquisition of new resources, it is likely to develop only a limited set of new resources, which are typically not complex. Given the nature of strategic processes, this explains why firms under stress react with "defensive" restructuring, aimed at improving cost rather than value position. Hence, the first conclusion resulting from these considerations is that Croatian and Slovenian firms perceiving the need for fast change of competitive position were likely to engage in defensive restructuring.

The second conclusion is a logical extension of the first. Firms unable to base their low-cost strategy on sustainable cost advantage gained through valuable, rare, imperfectly imitable, and not substitutable resources but have through defensive restructuring changed their perception of time pressures, and firms that perceived the need for change as a less immediate one, were likely to engage in "strategic" restructuring, aimed at development of the resources needed for achieving sustainable advantage (either on a cost or value basis).

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<sup>72</sup> To illustrate this statement, which is further elaborated in Chapter 5, in the first period of change firms were not allowed to borrow money in international markets; they had very limited access to information on the functioning of the financial markets; they had no experienced financial executives and there were virtually no such executives in the labor market; the banks formed an effective oligopoly to control the prices in local financial market, etc.

It should be noted that in both cases the perceptions of the firm were influenced by institutional determinants, as predicted earlier.

### 3.2.3 The resource-based view in a dynamic environment

The conclusion that strategic resources have to fit the environment, both in terms of the bundle structure and, more particularly, in the nature of the resources, not only sounds logical, but also directly eliminates one of the major potential arguments against the resource-based view as completely inward looking and thus detached from reality. However, the very notion of fit with environment unearths another major objection to the resource-based view: its static nature. If the environment is changing dynamically, then the resource-based view should propose how the company should treat its resources in order to sustain its competitive advantage. Some of the early work done in the area identified this problem [Leonard-Barton 1992], suggesting that specialization of resources, which may generate competitive advantage in a static environment, leads to disadvantage where there is environmental change.

The growing concern about the static nature of the resource-based view (e.g. Barney [1997] claims that “if a firm’s threats and opportunities change in a rapid and unpredictable manner, the firm will often be unable to maintain a sustained competitive advantage”) has been addressed by a number of scholars, especially since a major contribution from Teece et al. [1997]. They have developed the notion of *dynamic capabilities* as “the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments” [Teece et al. 1997]. Although some scholars subsequently questioned whether the notion of dynamic capabilities is a truly new addition to the resource-based view<sup>73</sup>, there seems to be some innovation in it. In the traditional view, current firm resources and capabilities are matched to the current opportunities in the market. In the dynamic capabilities view, the firm needs to develop dynamic capabilities to identify new opportunities and react to them. Thus the focus shifted from the Ricardian to the Schumpeterian nature of rents, and from resources to capabilities [Teece et al. 1997]. This approach converges with the continuing work of Hamel and Prahalad, their proposal that firms should take an active role in shaping the future of their industries [Hamel and Prahalad 1994] and their notion of “strategy as revolution” [Hamel 1995].

Work related to dynamic capabilities was further extended by scholars focusing on what Eisenhardt called *high-velocity markets* [Eisenhardt 1989] and others call a turbulent environment [Chakravarthy 1997] or the new competitive environment [Bettis and Hitt 1995, Hitt et al. 1998]. They share the opinion that resource-based view concepts are only partially true because they center on leveraging bundled resources to achieve long-term competitive advantage, while the strategy of high-velocity markets concerns the creation of a series of unpredictable advantages through timing and loosely-structured organization [Eisenhardt and Martin 2000]. While moderately dynamic markets require capabilities in the form of routines (stable processes) with predictable outcomes, high-velocity markets require simple, highly-experiential processes with unpredictable outcomes. In moderately dynamic markets competitive advantage is destroyed from the outside, in high-velocity markets both from the outside and from the inside (e.g. by losing the structure-level balance required to sustain dynamic capabilities). In moderately dynamic markets, causal ambiguity results from complexity, while in high-velocity markets it results from simplicity and lack of structure [Eisenhardt and Martin 2000]. Eisenhardt and Brown [1999] also extend this view from

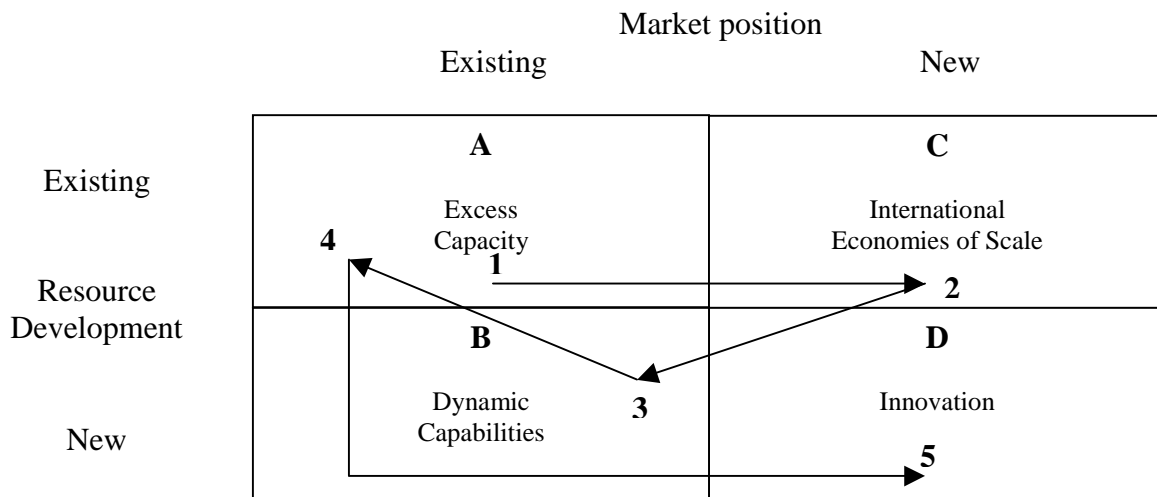
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<sup>73</sup> Barney et al. [2001] state it simply: “Put differently, ‘dynamic capabilities’ are simply ‘capabilities that are dynamic’”, implying that the notion of dynamic capabilities is not new to the resource-based view.

business level to corporate level strategy, calling for the continuous remapping of business units.

While in some industries Croatia and Slovenia represent high-velocity markets – with constant changes in the political, social and economic environment contributing to velocity more than technological changes or the inherent nature of competition – other segments have been better insulated from change. According to the predictions from the literature review above, one would expect firms to judge the importance of the flexibility of resources according to the perceived velocity of the markets (or the environment in general).

One conclusion of this stream of research is that the order in which capability-building is implemented is important [Henderson 1994, Iansiti and Clark 1994, Eisenhardt and Martin 2000, Pettus 2001]. Based on his empirical study of the effects of deregulation on the trucking industry, Pettus [2001] proposed an interesting model for the optimal sequence of resource development and market positions, presented in Fig. 3.2.



Source: Pettus [2001]

Figure 3.2 Hypothesized resource-based sequential path

Without detailing the theoretical explanation of the growth sequence model, which is well presented in the related literature [McGee and Thomas 1994, Chang 1995, Bogner et al. 1996, Pettus 2001], I find it of interest to compare the growth sequence path (where growth can also have a minus sign, implying a *transformation path*) of firms in countries in transition with that proposed by Pettus. The empirical research could provide evidence as to whether if the firms followed the pattern of moves predicted by Pettus, they resorted to some other pattern or followed none in particular.

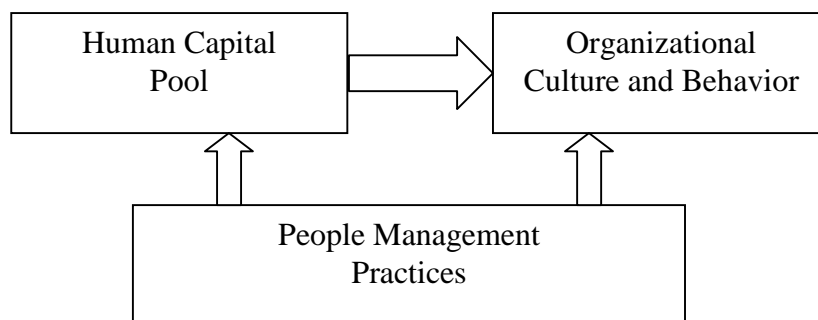
### 3.2.4 Role of human resource and organizational culture in the resource-based view

The importance of human resources and organizational culture for firm performance is a permanent source of challenge for researchers and theoreticians. Some of the most popular books on management, high on international bestseller lists, address this issue [Peters and Waterman 1982, Senge 1990]. Recent text by the most respected scholars often name people (employees and management) as the source of competitive advantage [Pfeffer 1994, Bartlett and Ghoshal 2002].

The argument concerning the growing importance of human resources goes hand in hand with that about the diminishing role of tangible resources [Pfeffer 1994]. If the main assumptions of the resource-based view on the importance and character of imitation barriers are true, then the tacit nature of people-related issues in organizations certainly has implications for the potential value of human resources and culture in competitive advantage [Wright et al. 2001]. Also, the resource-based view accords well with work done in the area of strategic human resource management [Miles and Snow 1984, Cappelli and Singh 1992, Wright et al. 1994, Snell et al. 2001], which claims that a certain type of strategy demands a unique set of behaviors and attitudes from employees, and that certain human resource policies produce a unique set of employee responses [Cappelli and Singh 1992]<sup>74</sup>.

Empirical studies of the influence of human resources and organizational culture on firm performance seem to confirm this view [Peters and Waterman 1982, Denison 1984, Whipp et al. 1989, Cutcher-Gershenfeld 1991, Gordon and DiTomaso 1992, Arthur 1994, Huselid 1995, MacDuffie 1995, Becker and Huselid 1998]. Research also links negative performance outcomes with problems that firms have with human resources and/or culture [Crozier 1964, Riley 1983, Tichy 1983b]. However, studies also clearly indicate that it is not easy to deal with such complex phenomena empirically (and especially not quantitatively). Thus, while many methodological issues concerning research validity remain open [Becker and Gerhart 1996, Wright et al. 2001], conceptual evidence for the time being supports and supplements the somewhat lacking empirical data.

A particularly interesting line of discussion has emerged within the resource-based perspective on the role of human resources for company competitive advantage. Most scholars make a clear distinction between three key strategic HRM components, as presented in Fig. 3.3.



Source: adapted from Wright et al. [2001]

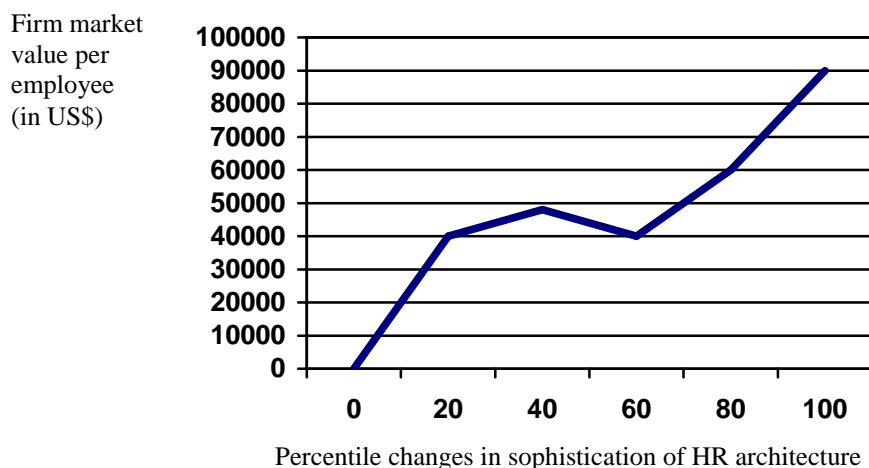
Figure 3.3 A model of the basic strategic HRM components

What appears to be unclear is the relative importance of each component in the model for company competitive advantage. When applying the concept of value, rarity, inimitability and substitutability, Wright et al. [1994] argued that HR practices could not form the basis of sustainable competitive advantage, since any individual HR practice can be easily copied by competitors. They proposed that the human capital pool (i. e., individuals having specific

<sup>74</sup> From the resource-based view perspective this translates into the fit between resources and environmental conditions [Amit and Shoemaker 1993, Teece et al. 1997], and accords with the general claim about the path-dependent outcomes of resource deployment [Barney 1991, Teece et al. 1997].

knowledge, skills, abilities and attitudes<sup>75</sup>) had greater potential to be a source of sustainable competitive advantage. Disagreeing, Lado and Wilson [1994] proposed that HR systems (and not individual practices) are socially complex and path-dependent, thus being impossible to imitate. This point of view seems to be better accepted within current research [Snell et al. 1996, Wright et al. 2001]. However, more recent studies suggest the integrative nature of the model presented in Fig. 3.3, with all three components providing significant contribution potential [Boxall 1998, Lepak and Snell 1999]. They also suggest that a variety of strategies may be used within one firm, since some groups of employees, various people management practices or some elements of the organizational culture may have a significantly higher strategic importance for the firm competitiveness than others [Lepak and Snell 1999, Lepak and Snell forthcoming].

To close this discussion, it is worth underlining the difference between fragmental and systemic application of the components presented in Fig. 3.3. Huselid and Becker [1995] provide interesting results of an empirical study on the impact of high performance work systems<sup>76</sup> on company performance. They suggest that firms can obtain some benefit from individual best practices such as self-directed work teams, job rotation, problem-solving groups, conflict resolution, TQM, contingent pay, training etc., [Huselid 1995, Becker and Gerhart 1996], but that the greatest impact can be generated from systemic effects (Fig. 3.4).



Source: adapted from Huselid and Becker [1995]

Figure 3.4 Market value of the firm (in US\$ per employee) as a result of quantum of adoption of high performance work practices

While an analysis of the huge body of literature on organizational culture is outside the scope of this work and will only be partially covered in my analysis of the strategic change management process, some of the often cited traits of effective cultures include trust, teamwork and open relationships, open communications, sharing of resources across organizational units, consensus seeking, commitment (from the top), appreciation of

<sup>75</sup> While Wright et al. [1994] in particular discuss the motivation of individuals to work productively, it remains open whether to treat this as a part of the human capital pool or of organizational culture. This implies a possible imperfection in the model presented in Fig.3.3, in which the arrows suggest a unidirectional influence of people management practices on the human capital pool and organizational culture, as well as of the human capital pool on organizational culture, while in reality the loop is closed and organizational culture exhibits a strong influence on the other two components.

<sup>76</sup> The work is based on research into High Performance Work Practices, including comprehensive employee recruitment and selection procedures, incentive compensation and performance management systems, and employee training and development [Jones and Wright 1992, U.S. Department of Labor 1993, Huselid 1995]

flexibility, tolerance of failure as a result of experiment or stretch, support for learning and human development, drive for quality, long-term vision and ethical values [Kotter and Heskett 1992, Hitt et al. 1997, Powell and Dent-Micaleff 1997].

I strongly believe that the importance of human resources and culture for the competitiveness of companies in Central Europe is tremendous. Not only is this a logical conclusion based on the findings presented in the literature review, but it is also founded on the “second-order” effects which I assume based on the analysis of the environment presented in Chapter 2. To start with, labor costs in the companies in the region were a true problem due to low productivity, despite low unit cost. This clearly implies that companies from Croatia and Slovenia were likely to focus on managing these costs in the same way as their counterparts from developed market economies [Saratoga 1994]. Reduction in employment as a major element in the strategy is a lasting temptation [Zook and Rigby 2002] and has significant potential long-term consequences for deterioration of competitiveness [Becker and Gerhart 1996]. On the other hand, in order to effectively use human resources and organizational culture as sources of competitive advantage, firms must develop complex capabilities [Barney 1986, Barney 1991, Amit and Shoemaker 1993, Thee ce et al. 1997], which requires time – one resource of which companies in transition had precious little. Some scholars have identified identity issues [Schein 1985, Fiol 1991] as crucially important in achieving effective organizational culture, and individuals and firms in the region had faced loss of identity.

Another specific issue for consideration was the extremely limited pool of managerial talent available during the first stage of change<sup>77</sup>. The same applies to almost all the employee profiles requiring the various “market economy” skills (such as corporate finances, marketing, and human resource management). Finally, regardless of the differences in the definition of culture among many scholars (e.g. [Schein 1985, Barney 1986]) and the impact of national culture on organizational culture [Hofstede 1991, Trompenaars and Hampden-Turner 1997], discontinuous change of the magnitude present in countries in transition implies the need for major changes in organizational cultures to fit the new environment. This, in turn, means that strong but rigid cultures could not be assumed to be a source of competitive advantage.

Following the above observations one easily concludes that management of human talent received significant attention and was one of the key elements of all strategic actions in the process of change in Croatia and Slovenia. However, empirical research needs to identify the common points in the approach and whether they differed from one phase of restructuring to another, since the literature provides contradictory predictions on the issue. Another assumption may be that a sense of identity was the primary element of the culture used to support the change.

### 3.2.5 Conclusions concerning the competitive advantage literature review

Given the characteristics of the transition process, in particular the combination of discontinuous change in the first phase and continuous change in the second, plus the specific environmental setting as described earlier, I find no single theory of competitive advantage

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<sup>77</sup> This fact was clearly identified in research on the need for management development in Slovenia [Filipović and Gudić 1999]. The situation in larger countries was even more dramatic: McKinsey & Co. estimated that not only were several hundred thousand managers lacking in Central and Eastern Europe, but the Russian Federation alone would need at least 2,000 professors of management-related disciplines to fill the gap in business schools and executive development institutions [Kraljić 1995].

fully applicable to the firms observed in Croatia and Slovenia. The resource-based view and especially the concept of dynamic capabilities come closest, but partly due to the extremely broad concepts they present, their translation into concrete, normative implications for managers is not easily obvious. I have outlined the assumptions derived from key findings of the competitive advantage literature, and how they apply to the firms observed.

In particular, I believe that dynamic, path-dependent development of resources was important for the success of these companies undergoing a two-stage process of change in the environment. The required resource configurations differed significantly from one phase to the other, as did the influence of institutional and industry structure factors. However, I also believe that the change management process was important for the outcome, which none of the competitive advantage theories address in the necessary detail. Thus, I shall also review the literature dealing with the change management process itself, and in particular with leadership intervention, before I build the research model in its entirety.

### 3.3 Strategic change management

As noted in the introduction to this chapter, the body of literature and research devoted to organizational change is huge and diverse. The broad definition of (organizational) change as *empirical observation of a difference in the form, quality or state over time* [Van de Ven and Poole 1995] seems to be well-accepted in academic literature [Rajagopalan and Spreitzer 1996, Szamosi and Duxbury 2002]. Popular literature typically does not offer this kind of definition, but deals with phenomena that can easily be related to the above wording.

The comment on unclear terminology made in 3.1 is equally true for the field of strategic change management. One has to be careful with the use of terms, since many authors describe essentially the same phenomena in different words. A good example is the use of “revolutionary change” [Greiner 1972, Gersick 1991], “radical change” [Tushman and Romanelli 1985, Greenwood and Hinings 1996], “transformational change” [Pettigrew 1987, Burke and Litwin 1992], “second order change” [Watzlawick 1978, Meyer et al. 1993], and “discontinuous change” [Hinings and Greenwood 1988, Nadler and Tushman 1995], which sometimes differ minimally in their underlying definitions and often refer to very similar manifestations in organizations. Also, identical terms are used with different meanings (e.g. discontinuous change in terms of the change in the environment [Ansoff 1965] or organizational change [Nadler and Tushman 1995]).

Unfortunately, the gap between theory and practice in the field of strategic change management remains relatively wide despite the fact that a significant amount of research is based on empirical data and many leading theoreticians act as management consultants [Lichtenstein 1997]. One empirical study has confirmed that academics and practitioners rarely communicate or use each other’s knowledge [Barley et al. 1988]. This situation to a large degree results from the different approach of the two groups to the organizational context, and from different motivations [Miller et al. 1997]: popular authors and consultants expect senior management to be their principle audience and make them their focus, often ignoring the “dark side” of the change and overstating its manageability. On the other hand, academics often ignore the context, deal with oversimplified constructs and avoid being prescriptive to the extent of having no practical relevance. In the remaining part of the literature overview I shall try to bring together both views by reflecting on popular change models in respect to underlying theory and by pointing out the practical usefulness of the theoretical concepts reviewed.



The breadth of the concept of strategic organizational change allows researchers to look at it from various perspectives. Some deal with the very nature of change, and often involve analysis of the reasons for resistance to it as well as other major factors influencing the way changes unfold. Others focus on the integrative nature of change, placing it in a context and discussing the links between the outer and inner environment of the organization, the need for change, its contents and the process via which it is implemented. Another group of authors presents detailed, pragmatic models of change aimed at suggesting the optimal course of action for achieving successful change in the organization. Yet another group extends its focus to the key actors in change – leaders and employees – as well as to the effects of organizational culture on change. Each of these topics is dealt with below.

### 3.3.1 The nature of change

Early work on organizational change emerged from the organizational development tradition and stressed techniques for planned transition management [Bennis et al. 1976, Beckhard and Harris 1977]. It often focused on relatively low managerial levels within an organization and on incremental changes “owned” by employees [Quinn 1980]. This became obviously inappropriate in the face of company developments in the 1980s; more coercive approaches to change began to dominate, and large-scale (second-order) changes became the principal domain of analysis [Tichy 1983b, Kimberly and Quinn 1984, Pettigrew 1985]. Discussion aimed at revealing the differences between incremental and strategic change, the latter involving changes in the organization’s purpose and/or that of several major organizational systems. This was accentuated in some of the popular change models built around Greiner’s notion of periods of evolutionary and revolutionary change [Greiner 1972]. Coming from another perspective but pointing in the same direction, the notion of discontinuity was further developed by Miller and Friesen in their work on the quantum nature of change [Miller and Friesen 1980a, Miller 1982, Miller and Friesen 1984], as well as by Tushman and Romanelli in their model of punctuated equilibrium [Tushman and Romanelli 1985, Tushman et al. 1986, Tushman and O’Reilly 1996].

This opens one avenue of discussion about the nature of organizational change: is it continuous or discontinuous in its manifestations in the organization<sup>78</sup>? Proponents of continuous change claim that constant change in the environment demands continuous adaptation [Kagono et al. 1985, Nonaka 1988] and that continuous improvement is a more effective response than massive change [Stacey 1993]. They focus on continuous learning [Argyris 1990, Senge 1990] and unlearning [McCaskey 1982] and promote tools such as Kaizen [Imai 1986] and learning organizations [Senge 1990]. They also share the opinion that change can be led, but not imposed from the top [Bourgeois and Brodwin 1983]. On the other side, proponents of the discontinuous change perspective claim that due to inertia pressure has to be built to start change, creating “boom and bust” cycles [Miller and Friesen 1984, Tushman et al. 1988] and requiring competence in revolutionary change [D’Aveni 1994, Hamel 1996]. A typical change tool proposed is business process reengineering [Hammer 1990, Hammer and Champy 1993]. Achieved success reinforces stability [Miller 1990], which leads to efficiency [Thompson 1967]. However, in periods of stability, barriers to change develop because of organizational inertia [Hannan and Freeman 1984, Kelly and Amburgey 1991], uncertainty [Argyris 1990], preservation of perceived self-interest [Pettigrew 1988], strategic lock-in [Arthur 1996], and many other factors. Eventual crisis is unavoidable, due to environmental jolt [Meyer 1982, Meyer et al. 1990] or gradually growing lack of fit with the environment [Johnson 1988, Strebel 1992]. Finally, proponents of the

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<sup>78</sup> As noted earlier, various authors use different terms to denote this dilemma.

discontinuous change perspective often take the view that change should be initiated from the top and can be carried out by a handful of change agents [Maidique 1980, Day 1994].

Another view can be taken of the nature of change: are firms adaptable to the pressures for change, or do they resist them? Traditional responses from *contingency theory* (often called the *adaptive view*) suggest that organizations can control their destinies by actively and purposely creating a fit between the structure of the organization and the demands of the environment, size and technology [Lawrence and Lorsch 1967, Thompson 1967, Child 1972]. Leaders and dominant coalitions in companies have a duty to assess environmental changes and decide on the strategies and actions to match them. Organizations achieving this fit are more likely to have higher performance levels and better survival chances. Along with the concept of adaptation, authors note the dependence on critical resources and propose that organizations should take active steps to minimize the related uncertainties [Cyert and March 1963, Thompson 1967, Pfeffer and Salancik 1978]. Thus, actions may take the form of adapting the organization to the environment, but sometimes even act upon the environment to alter it.

In parallel to contingency theory, another adaptive view of organizational change was presented by the *organizational learning* perspective [Levinthal and March 1981, Nelson and Winter 1982, Senge 1990]. It takes the position that organizational learning consists of organizational modifications based on feedback from the organizational environment. If the environment has been accurately investigated, organizational change should be adaptive. However, this perspective does not imply an intentional character in change as does the contingency view, but rather suggests that creating preconditions for adaptability through learning is the main task of leaders.

Two different points of view have emerged and gained dominance in the last two decades, both claiming that due to a number of factors organizations only rarely make major adaptive changes, and that changes are in principle disruptive for organizations. Although sharing these assumptions, plus several concepts including structural inertia and the liability of newness, the *institutional view* and the *population ecology view* differ in their underlying theory.

Institutional theory (DiMaggio and Powell 1983, Meyer and Rowan 1977, Zucker 1987) suggests that socially-constructed belief systems become institutionalized in organizations and their structures [Scott 1987]. In order to gain legitimacy and increase their stability and survival possibilities [Zucker 1987], organizations demonstrate their conformity to the institutional environment by incorporating environmentally-embedded [Stinchcombe 1965] and institutionally rationalized rules into their structures [Ibarra and Andrews 1993]. As seen in institutional theory, change is not unlikely per se, but it is of a continuous nature and the results of change are under normal circumstances convergent [Greenwood and Hinings 1996]. This is due to external institutional pressures enforcing norms of what constitutes appropriate organizational goals, structures and processes [DiMaggio and Powel 1991]. However, major change in the environment may induce radical organizational change [Greenwood and Hinings 1996]. The more embedded the organization is in the environment, the more likely organizational change will be revolutionary (radical in pace and size and transformational in size and scope) if the institutional context changes dramatically. This happens because a new institutional setting demands changed value commitments within the company. That, along with the appropriate new capabilities and the power balance within the company among the groups sharing a value commitment to the same organizational templates (i.e. set of strategies,

organizational designs and systems), allows the company to scan for new organizational templates, choose one that is more appropriate, and adopt it<sup>79</sup> [Greenwood and Hinings 1996].

A key barrier to change in the institutional view should be more precisely defined as a key barrier to diverging from a dominant model. It is expressed in the form of organizational inertia caused by the above-mentioned institutional pressures towards convergence, as well as skewed managerial perceptions resulting from these pressures and actions based on them<sup>80</sup> [Weick 1979, Giddens 1984]. Another inertia phenomenon involves the fact that the legitimacy of young organizations, as well as those who had recently gone through a major change, is low-level. Consequentially, institutional theory implies a higher risk of failure [Stinchcombe 1965, Hannan and Freeman 1984, Singh et al. 1986]. This effect is termed *liability of newness* and in the view of institutional theory implicitly presents an additional barrier to change, also contributing to the organizational inertia which leads to the model of evolution-revolution cycles noted above. Finally, another barrier to change identified by institutional theory is an excessive rate of institutional change, resulting in a lack of appropriate alternative organizational templates that would be seen by the company as functional and institutionally acceptable<sup>81</sup>. The high rate of change also potentially creates a skills and leadership vacuum [Newman 2000]. This means that the likelihood of organizational change as a function of institutional change in the environment drops when the rate of institutional change becomes excessive, thus following an inverted U curve.

Newman's analysis was carried out on the basis of the concrete institutional changes in Central and Eastern Europe during the period of transition to a market economy [Newman 2000], which potentially makes it highly applicable to the situation in Croatia and Slovenia. She related the search for and adoption of effective new organizational templates with organizational learning, and found three principle reasons why a high level of institutional change inhibits organizational learning (and, through it, organizational transformation<sup>82</sup>). They are: the diminished or eliminated relevance of existing resources and capabilities as sources of competitive advantage<sup>83</sup>; the diminished or eliminated relevance of existing organizational templates; and ambiguous cause-effect relationships which diminish or eliminate "learning from experience". As a result, firms rely excessively on existing routines, become strategically confused, and are too dependant on mimetic change. Newman also claims that firms less embedded in their previous environment and who possess higher absorptive capacity<sup>84</sup> are less at a disadvantage.

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<sup>79</sup> This process is based on the cognitive or emotional preference within the dominant group. The argument of preference was not noticed by Newman [2000] in her critique of the applicability of the concept of articulated alternative in a situation of institutional upheaval. When taken into account, it implies that there is no need for any realistic alternative to exist in order for the dominant group to accept it. If (having no clear clues) the group interprets a chaotic institutional context in a certain way, it can derive non-existing meaning. Furthermore, if this happens within a powerful company, it can cause mimetic change in a large group of companies and, according to institutional theory, significantly increase the likelihood of a successful change outcome for participants by creating new convergence.

<sup>80</sup> For this reason institutional theory suggests bringing the change leader from outside the organization, since this person can bring a new perspective to the organization [Bloodgood and Morrow 2000].

<sup>81</sup> This matches Brunsson's claim, that periods of ideological instability are poor contexts for action [Brunsson 1982].

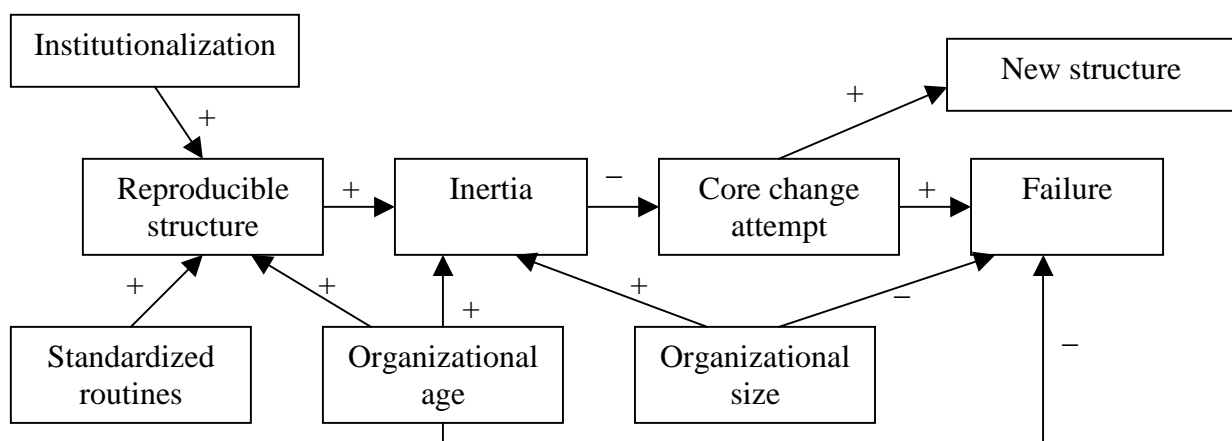
<sup>82</sup> Newman defined organizational transformation as change that leaves the organization better able to compete effectively in its environment; this refers implicitly to successful adoption of new organizational templates which prove valid for a firm's success within the new institutional context.

<sup>83</sup> This notion is conveniently borrowed from the resource-based view.

<sup>84</sup> Absorptive capacity is here a concept describing a firm's ability to learn and innovate [Cohen and Levinthal 1990, Zahra and George 2002].

The basic assumption in the initial statement of population ecology theory [Hannan and Freeman 1977], as noted in 3.1.6, was that organizations usually have a high level of structural inertia and are unable to make changes easily due to a variety of internal and environmental constraints [Hannan and Freeman 1977, Aldrich and Auster 1986]. Organizational adaptation is difficult, and the main mechanisms of population change are variation, selection and retention. Subsequently, Hannan and Freeman modified their proposal and stated that structural inertia is a result of the selection process, rather than a precursor [Hannan and Freeman 1984]. They also suggested that the inertia level for core aspects of the organization is much higher than for peripheral ones<sup>85</sup>. This leads to the interpretation that core aspects are best explained by the ecological view (because of the strength of inertia pressures), whereas peripheral changes are better explained by the adaptation view [Scott 1981, Hannan and Freeman 1984, Singh et al. 1986].

The model of structural inertia brought the ecological and institutional perspective close together (Fig. 3.5). However, the evolution perspective still sees the selection process within the population as the key driving force, and proposes that organizations with high levels of reliability, low variance in performance, and good accountability<sup>86</sup> are favored in the selection process. However, these same features lead to an increase in inertia.



Source: Kelly and Amburgey [1991]

Figure 3.5 A basic view of structural inertia theory

One of the implications of the model presented in Fig 3.5 is that as organizations get older, its members learn specific skills and routines [Nelson and Winter 1982] and the organizations become better at reproducing their structures [Singh et al. 1986]. This leads to a higher survival probability and offers another perspective on the “liability of newness” phenomenon, implying higher levels of organizational stability and structural inertia [Hannan and Freeman 1984, Kelly and Amburgey 1991, Amburgey et al. 1993]. The side-effect of the liability of newness phenomenon is what Amburgey and colleagues called “resetting the organizational clock” [Freeman and Hannan 1989, Amburgey et al. 1993]. In their study of Finnish newspapers they empirically confirmed that older organizations are less likely to experience change and are more disturbed by it once it happens. Also, once a change occurs, the likelihood of failure increases (despite the effect of organizational age, which becomes

<sup>85</sup> Core aspects of the organization, according to Hannan and Freeman [1984], include stated goals, forms of authority, core technology and marketing strategy in the broad sense.

<sup>86</sup> Accountability is used here as the ability to account rationally for organizational actions.

subordinate to the effect of time elapsed since the last change)<sup>87</sup>. Finally, change increases the likelihood of the same type of change in the future<sup>88</sup> [Amburgey et al. 1993].

Many other views of organizational change are feasible, such as random organizational action theory [March and Olsen 1976, Starbuck 1983], the integrated perspective [Rajagopalan and Spreitzer 1996], power [Pfeffer 1981, Hardy and Clegg 1996, Bradshaw 1998], politics and culture [Pettigrew 1973, Johnson 1987], the economic perspective of influence costs [Milgrom and Roberts 1988, Schaeffer 1998], and many others. Also, a plethora of authors offer combined views, trying to bring together one or more theories (e.g. Bloodgood and Morrow [2000] combining institutional and RBV frameworks; Newman [2000] integrating institutional theory and organizational learning; Amburgey et al. [1993] combining structural inertia and organizational learning; Singh et al. [1986] combining population ecology and adaptation views; Bacharac et al. [1996] combining logic of action and cognitive dissonance; etc.). Although some of these ideas are interesting, for reasons of brevity and clarity I have not commented on them.

While the adaptive and inertia theories deal extensively with issues involving the nature of change and in particular the barriers to it, they also directly or indirectly make assumptions about pace and magnitude of change. The issue of pace can be further divided into rhythm (tempo) of change and its timing, while magnitude can be defined both in terms of amplitude and scope [de Wit and Meyer 1998]. These assumptions are not identical for all the authors representing a single view, and overlap even more for researchers subscribing to a blended view (as described in the previous paragraph). Nevertheless, before summarizing the implications of different theoretical frameworks for the change situation in Croatia and Slovenia it may be worthwhile to briefly compare the dominant views of major theories in respect to pace and magnitude of change, as presented in Table 3.3.

|           | Contingency view | Learning organization | Inertia theory <sup>89</sup> |                  |
|-----------|------------------|-----------------------|------------------------------|------------------|
|           |                  |                       | Evolution phase              | Revolution phase |
| Amplitude | Any              | Low                   | Low                          | High             |
| Scope     | Any              | Broad                 | Narrow                       | Broad            |
| Rhythm    | Fast             | Slow                  | Slow                         | Fast             |
| Timing    | Short-term       | Long-term             | Long-term                    | Short-term       |

Table 3.3 Comparison of assumptions about magnitude and pace of change

I will start with an overview of the applicability of the theoretical concepts described to the change situation in Croatia and Slovenia, by looking at the nature of environmental pressures, as described in Chapter 2. Without going into detail, one can easily see that both periods of external change (described in Chapter 2 as discontinuous and continuous) were characterized by an extremely high level of institutional change, although the level in the first phase was

<sup>87</sup> Another consequence of this view is the assumption that organizations undergoing repetitive change without periods of recovery may seem adaptable, but have a significantly increased likelihood of failure.

<sup>88</sup> Again, this can be explained by the inertia theory: once change in an organization is “set in motion”, it tends to keep changing since the marginal cost of a certain type of change has decreased. However, this increases the risk of the wrong type of change being applied if a different, new problem appears after the first has been successfully solved.

<sup>89</sup> A synthesis of institutional and population ecology views is presented, both according to more recent formulations suggesting distinct evolutionary and revolutionary phases in organizational development [Hannan and Freeman 1984, Nadler and Tushman 1995]

higher than in the second. The structure of stakeholders and their institutional expectations changed from one period to another, as well as (to a somewhat lesser degree) within each period. Thus, I assume in my interpretation that as the external environment influencing management in forming their responses was changing over time, so were these responses. However, empirical research should show whether they were homogeneous for all companies or – more likely according to the above considerations – were additionally influenced by the concrete industry or company setting.

A great increase in organizational mortality, especially during the first period of change, clearly indicates that contingency theory cannot be universally applied to the observed processes<sup>90</sup>, since it does not predict significant difference in failure rate based on the change undertaken. On the other hand, institutional influences and structural inertia seem to offer explanations for the type of change and the observed difference in failure rates. However, more detailed analysis is needed to see if the observed phenomena truly match the predictions of these theories, and which fine-grain prediction from which of the theory can be treated as confirmed. Conceptual considerations such as those proposed by Newman [2000] serve as a good starting point.

From the popular view of change as a sequence of evolution-revolution patterns, one can easily assume that the first period of change was revolutionary (and that those aspects of inertia theory dealing with revolutionary cycles should be taken into account). However, it is not intuitively clear whether to treat the second period of change as evolutionary or revolutionary. On the one hand, its high level of institutional change suggests it should be seen as revolutionary. On the other, mainstream theoretical views suggest that two consecutive periods of revolutionary change without an intervening period of stability are unlikely, will result in extremely high failure rates, or are even impossible. In the case of countries in transition, though, “period of stability” is a relative term, referring to less than discontinuous change, rather than stability in the true sense of the word [Breu and Benwell 1999]. Thus I assume that companies were likely to enter defensive restructuring first and then follow it up with strategic restructuring. However, prolonged defensive restructuring was possible, based on a interpretation of the environment as requiring immediate change of high magnitude.

Theory assumes that managing evolutionary and revolutionary change requires different organizational templates. Some authors suggest that organizations should be able to deal with both types of change simultaneously in order to be successful<sup>91</sup>. In accordance with the previously stated conclusions, I expect that organizational templates changed from the period of defensive to strategic restructuring.

I consider valuable views stating that mimetic change gains in importance during periods of institutional upheaval. However, I supplement them with the notion that organizations which had high levels of historical legitimacy significantly influenced the way the environment was interpreted in Slovenia and Croatia. They served as role models for other firms as well as for each other, thus reducing the variety of responses to change<sup>92</sup>.

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<sup>90</sup> As will be shown later, contingency theory can be applied in special circumstances.

<sup>91</sup> This applies in particular to the work of Tushman, but some authors dealing with change issues from other perspectives have come to the same conclusion [Abell 1993, Tushman and O'Reilly 1996].

<sup>92</sup> It should be noted that this explanation places historical legitimacy above fit between the chosen template and the changing (but still chaotic) environment. This comes close to the contingency view about organizations being able to influence the environment.

Finally, I find relevant the insight into the limited possibilities for organizational learning in periods of institutional upheaval, not only because of the initially-proposed implications of institutional theory, but also in view of the evolutionary perspective and in particular the lack of slack in the critical resources (including time) needed for learning during these periods. I consequently assume that throughout the period of defensive restructuring firms did not base their change efforts on the effects of organizational learning.

### 3.3.2 Content, context and process of change

Some authors disagree with the mainstream schools of thought because of one intuitively highly appealing objection: it is unrealistic to expect that universally-successful patterns of change can exist. In other words, the content, context and process of change are mutually dependent. Consequently, any given change effort may be driven by a different set of influences, and while certain aspects of that particular change can be explained by one theory, other aspects may reflect phenomena predicted or explained by another. While many authors make gestures in this direction, typically discussing one particular aspect of change or trying to build a more universal theory that would integrate various theoretical perspectives, few have explicitly addressed the holistic view of change. While some have remained primarily at the conceptual level [Pettigrew 1987], others have tried to build theoretical [Burke and Litwin 1992] or normative application-oriented [Vollmann 1996], integrative models of change.

In his early work on change, Pettigrew developed the view of organizational change as a process determined by politics and culture [Pettigrew 1973, 1979, 1985]. While considering the effects of leadership on change, in particular the concept of transformational leadership [Burns 1978, Tichy and Ulrich 1984, Bennis and Nanus 1985, Tichy and Devanna 1990], Pettigrew concluded that much writing on leadership lacks a thorough analytical background [Pettigrew 1987]. He proposed that phenomena related to change should be approached with a clear reference to the outer and inner context of the organization, change content and process [Pettigrew 1987]. Together with Whipp and Rosenfeld he later refined the context-content-process model of change (Fig. 3.6).

While the details of the above framework and Pettigrew's insistence on power and culture as underlying phenomena explaining change may be subject to debate<sup>93</sup>, the framework clearly points out the complex character of change and the need to examine it holistically.

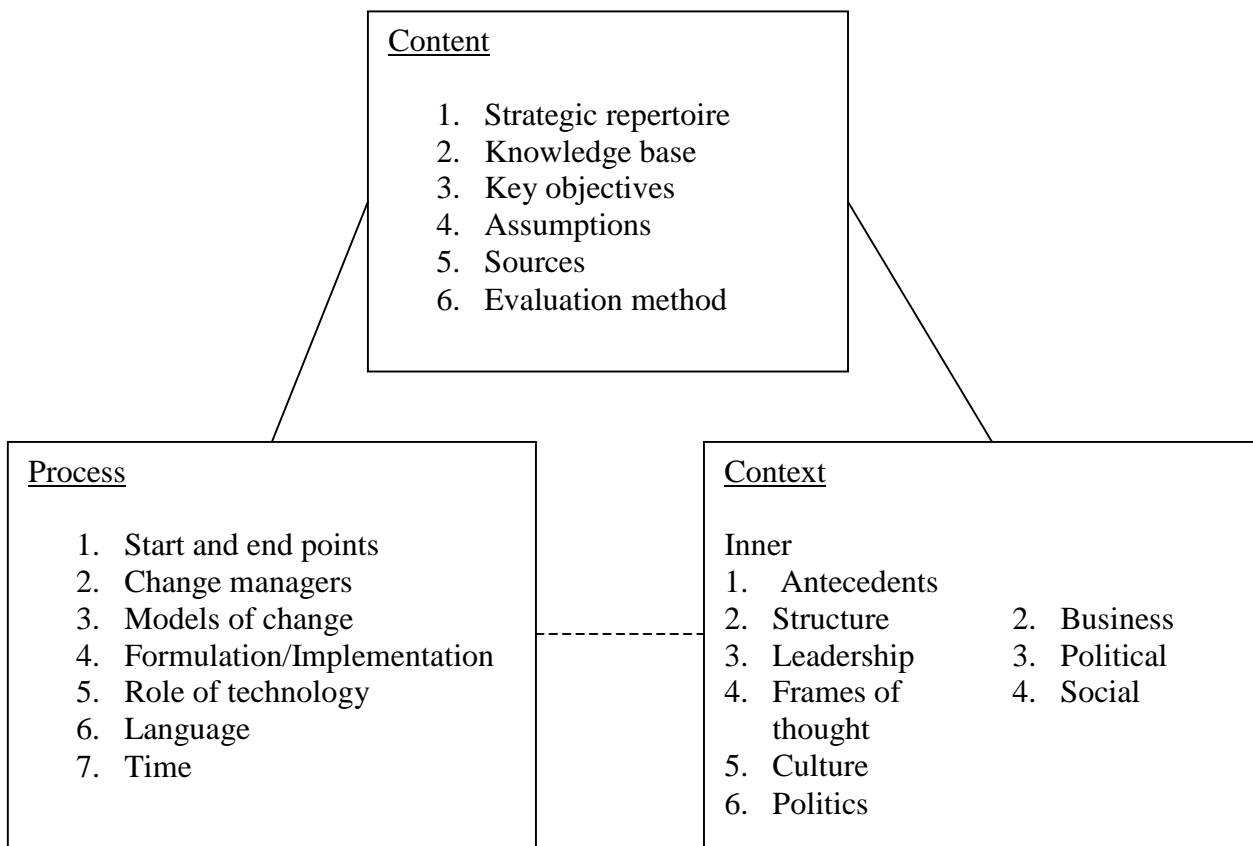
Burke and Litwin [1992] built their model of organizational performance and change on the basis of their own consulting experience, previous theoretical developments in the area of transactional and transformational leadership [Burns 1978], and organizational models linked to organizational behavior, climate and culture [Weisbord 1976, Nadler and Tushman 1977, Peters and Waterman 1982, Schneider 1985]. The model proposes 12 key variables influencing organizational change and organizational performance. According to the propositions of the open system theory [Katz and Kahn 1978], variables influence each other bi-directionally, but transformational variables have a stronger impact than transactional ones<sup>94</sup>. Although the model (Fig. 3.7) appears complex, it can be seen as a systematic

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<sup>93</sup> E.g., the literature suggests that technology should be included as the fifth issue in the outer context, and current performance should be included in the inner context.

<sup>94</sup> Transformational variables are external environment, mission and strategy, leadership, and organizational culture. Burke and Litwin referred to the work of Kerr and Slocum on the links between organizational culture and reward systems [Kerr and Slocum 1987] as one illustration of the variable hierarchy.

extension of the popular McKinsey 7S model [Peters and Waterman 1982], and its value can be seen particularly in its attempt to explain transactional and transformational components of change holistically, and to associate change with individuals and the organization.



Source: Whipp et al. [1989]

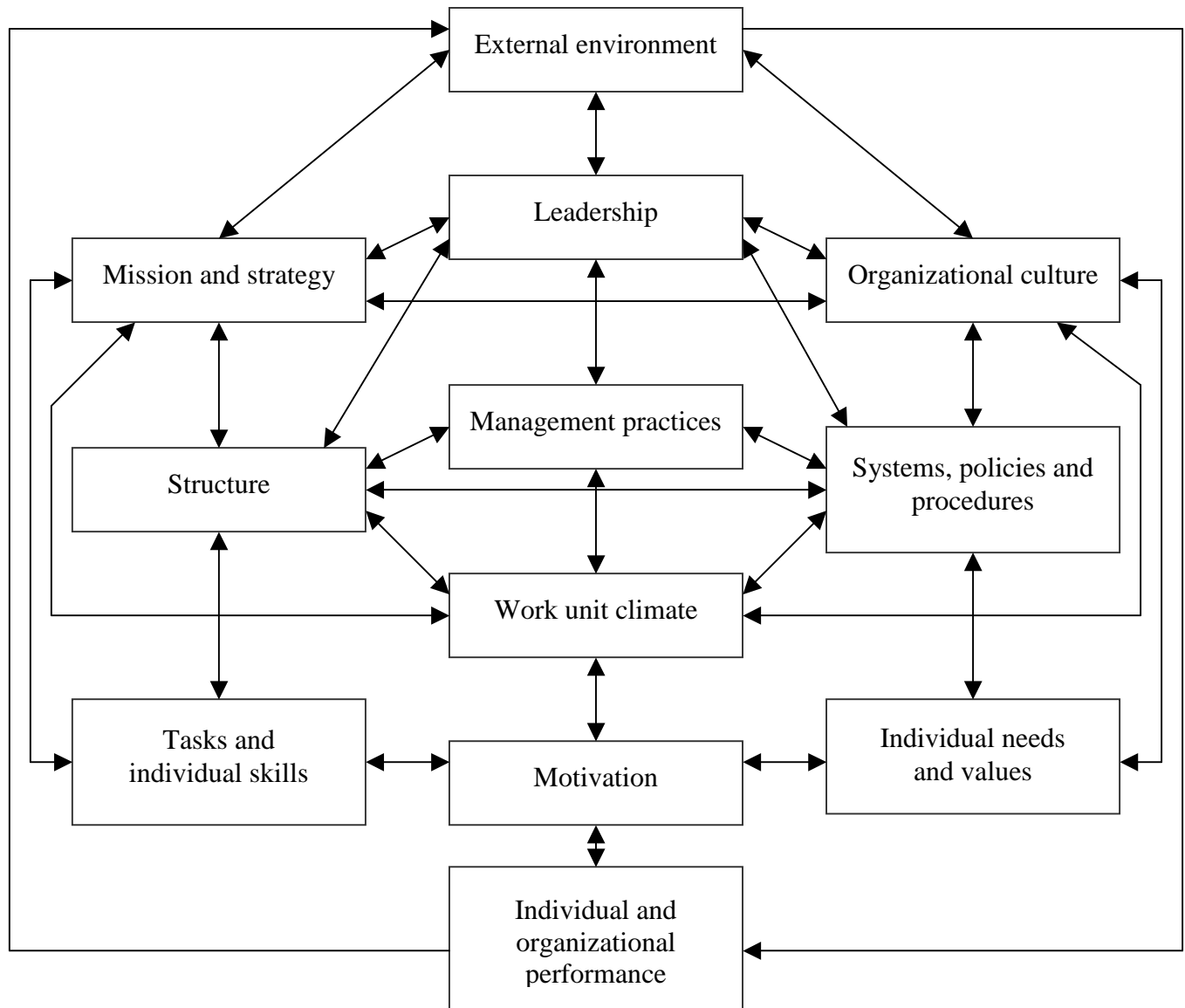
Figure 3.6 Competitiveness and the management of strategic and operational change

Burke and Litwin made reference to numerous studies supporting choice of variables and validity of interdependencies among the variables, but did not try to validate their model through their own empirical research. However, their attribution of organizational climate change to the set of variables they call transactional, and culture change to the set of variables they call transformational falls in line with other research on transactional (referring to changes achieved via short-term reciprocity among individuals and groups) versus transformational (referring to changes producing new behavior sets and organizational templates) change<sup>95</sup> [Burns 1978, Peters and Waterman 1982, Bass 1985, Pettigrew 1988, Tichy and Devanna 1990]. Burke later reframed the model to point out more clearly the various dimensions of change, and to somewhat strengthen the process dimension<sup>96</sup> [Burke 1994, Siegal et al. 1996].

<sup>95</sup> Burke and Litwin [1992] propose an interesting parallel between transactional change and Zaleznik's concept of a manager, and transformational change and Zaleznik's concept of a leader [Zaleznik 1977].

<sup>96</sup> This is not surprising, given the consulting side of Burke's background and the prevailing interest of practitioners in the process view of change.



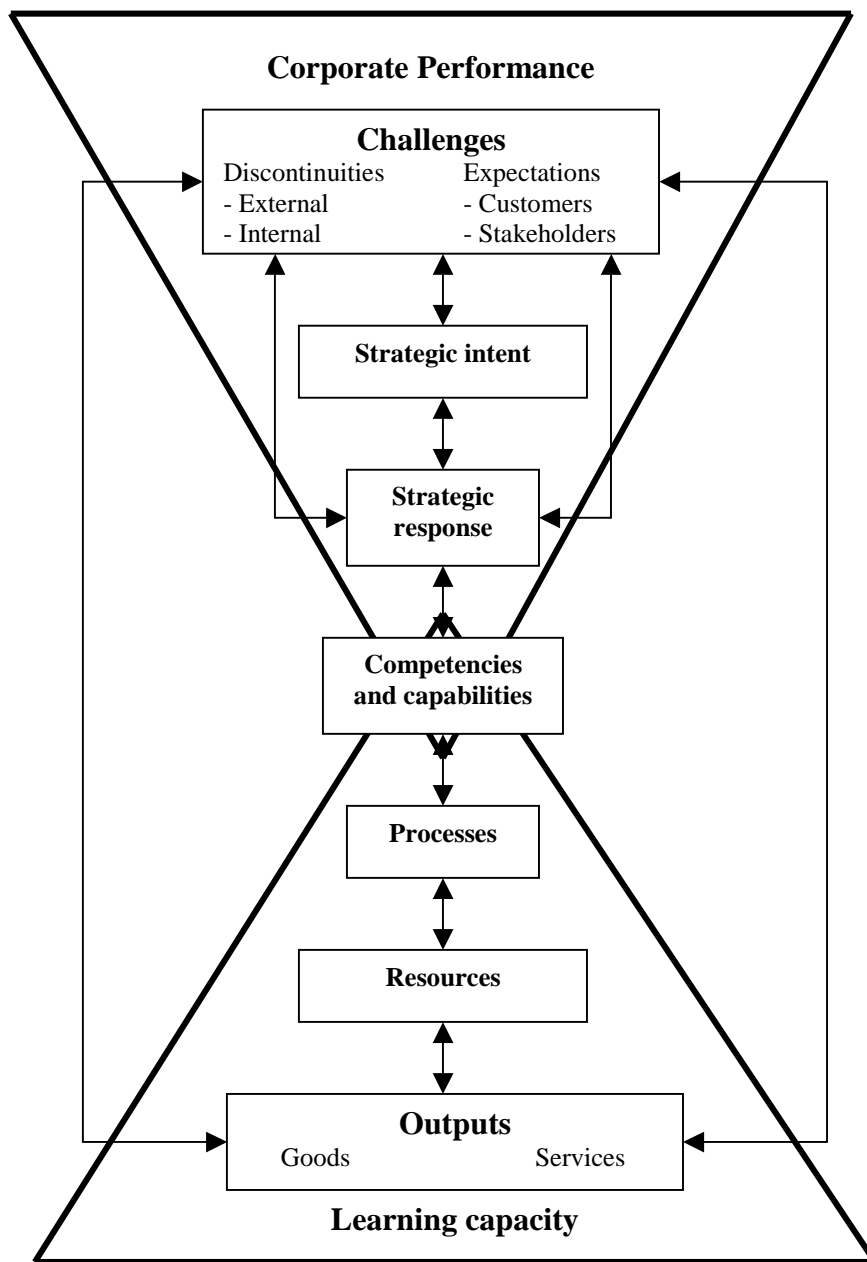


Source: Burke and Litwin [1992]

Figure 3.7 A model of organizational performance and change

Vollmann [1996] based his model on the findings of “Manufacturing 2000”, a major cooperative research project led by IMD Lausanne. The project had as its primary objective identification of the changing requirements for manufacturing excellence and the appropriate organizational responses. Vollmann noticed the integral nature of successful transformation efforts, as well as the evolution-revolution nature of change revealed by the project [Gould 1994]. Like most other academic authors of normative literature on change management, his implicit starting position sides with contingency theory, since he proposes “a blueprint for successful transformation”. However, in this he addresses many concerns shared in the basic theoretical models of change. His model of integrated strategic transformation (Fig. 3.8) addresses eight key organizational transformation facets and is built around the central concept of competencies and capabilities, as defined by the resource-based view [Prahalad and Hamer 1990, Stalk et al. 1992, Teece et al. 1997]. This concept is integrated with ideas

borrowed from the organizational learning perspective<sup>97</sup> [Nelson and Winter 1982, Cohen and Levinthal 1990], institutional perspective [DiMaggio and Powel 1983], and in particular with the concept of strategic intent [Hamel and Prahalad 1989].



Source: Vollmann [1996]

Figure 3.8 Model for integrated strategic transformation

Vollmann complements the model of eight key organizational transformation facets with the idea that each facet can be analyzed along three key organizational dimensions, and should consider developing and deploying three key organizational resources. The three organizational dimensions as proposed by Vollmann are culture, configuration and

<sup>97</sup> The concept of learning capacity as presented by Vollmann [1996] resembles that of absorptive capacity [Cohen and Levinthal 1990].

coordination<sup>98</sup>, while the key resources are people, information and technology. When preparing for transformation, managers should check each of the eight organizational transformation facets and try to understand the implications of that transformation facet for each organizational dimension and key resource.

Vollmann also suggests that for any transformation effort to be successful, it must be integrated, consistent, feasible and desirable. While the first three characteristics are supposed to come as a natural product of using his model, the last, critical for dealing with the “people” side of the change, is further elaborated through insights in the work of his IMD colleagues, in particular Jean-Marie Hiltrop’s work on new psychological contracts [Sparrow and Hiltrop 1994, Hiltrop 1995].

The three models of strategic change presented differ in many aspects: from purpose (ranging from conceptual to descriptive to normative) and explicit reference to theoretical sources, to suggested key organizational constructs and level of detail. Despite these differences, however, they share a few important features.

Firstly, all three models clearly indicate, even in their graphic representations, that change is a very complex phenomenon. They not only point towards many variables influencing change outcomes, but also propose that change occurs at three different levels: external (environmental), organizational and individual. This is a step ahead of the “purist” theories of change described previously. Also, all three models (in particular the latter two) try to be highly realistic in describing change. This has led the authors to assume a pragmatic attitude in their use of theoretical concepts, integrating views from different theories in order to achieve the level of realism needed. As a result, the level of associated detail allows managers to use these models in preparing change-related actions, and not just for ex-post-facto analysis and an understanding of observed outcomes.

However, the models also have significant deficiencies. Being complex, they are also quite difficult to apply, especially without additional external support, thus in reality reducing their value for practitioners. A more fundamental problem, however, is the tendency of the authors to treat organizations as inherently adaptive. Although they refer to change as “not easy to achieve”<sup>99</sup>, they are less explicit about the inherently negative aspects of change, the reasons for inertia and other change inhibitors, or any possible concrete remedies beyond a call for people development and motivation.

From the Central European perspective, one cannot but notice an interesting paradox: the more concrete the model is in prescribing change-related action, the more problematic is its application. Pettigrew’s model remains fairly conceptual and as such raises no controversy. At the other extreme, Vollmann’s model is built on several concepts which are highly controversial from the perspective of discontinuous change in the environment. One is reliance on organizational learning as the primary change mechanism. As discussed above [Newman 2000], organizational learning may be one of the casualties of institutional upheaval, and change models in countries in transition should not rely on it heavily. Also,

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<sup>98</sup> Vollmann defines culture similarly to Schein [1985], referring to values and beliefs, but states additionally that culture includes strategy. He uses the terms configuration and coordination in the traditional sense, referring to organizational design and deployment of resources, and to management and control.

<sup>99</sup> Vollmann writes: “People transformation is not easy. It never was, and it is not getting easier over time. (...) A primary implication is that companies need to spend more time improving their change mechanisms (transformation engines) instead of focusing exclusively on the next change result.”

Vollmann gives much importance to the notion of strategic intent. As originally proposed [Hamel and Prahalad 1989], this notion suggests, among other things, a clear understanding of “what is needed to win”, an excellent knowledge of competitors, and taking the time to digest one challenge before taking on another. While the first two factors were beyond the reach of the vast majority of organizations in Croatia and Slovenia during the first period of change, the third was universally unacceptable, it being highly unlikely that organizations in Croatia and Slovenia could develop strategic intent during defensive restructuring. However, some form of strategic intent should have been developed by firms going through strategic restructuring in order for them to be successful.

Burke and Liwitin’s model, in terms of level of detail, sits somewhere between the other two. Its most interesting contribution to an understanding of the change situation in Croatia and Slovenia is in the dominance of transformational over transactional factors. Taken strictly, it predicts that top-down change based on leadership intervention, strategy and culture will predominate over bottom-up change. This statement, however, contains an inherent, though less obvious paradox from the perspective of countries in transition, since exactly those variables are likely to be the ones most negatively affected by changes in the environment. Thus, in a way Burke and Litwin suggest that leadership and strategy were needed during defensive restructuring in order for firms to get through it successfully. This, however, does not necessarily imply a need for long-term vision during defensive restructuring.

### 3.3.3 Process-oriented models of change

A major stream of research within the field of organizational development deals with change process issues and generally addresses actions taken during an intended change. As noted in 3.3.2, such actions may be observed at the level of the environment, organizations and individuals. Adherents of the process view of change thus inherently accept the assumption that managerial action can influence change and produce the desired (planned) outcomes. Most explicitly acknowledge the validity of one of the oldest concepts in the notion of change: the idea that change develops in stages [Lewin 1947]. They also accept the idea that barriers to change (such as inertia) should be identified and dealt with in order for change to be successful [Lewin 1947, Drucker 1954, Schein 1965, Watson 1969, Argyris 1970]. They not only propose actions aimed at achieving successful change at different stages and against different barriers [Tichy 1983b, Kouzes and Posner 1987, Schein 1987, Beer et al. 1990, Kotter 1990, Kotter 1995, Tichy 1996], but also conceptualize common patterns and propose “standard change paths” [Miller and Friesen 1980b, Strebel 1992, Badden-Fuller and Volberda 1997, Beer 2001]. Finally, some propose the “magic bullet”, “the” concept that is “absolutely central” for the success of change (be it charismatic leadership [Conger and Kanugo 1988], strategic intent [Hamel and Prahalad 1989], mission [Campbell et al. 1992], vision [Quigley 1993], or less traditional concepts such as “Big Hairy Audacious Goal” (BHAG) [Collins and Porras 1996], or coherence [Lissack and Roos 2001]).

The roots of the process view of change lie in conceptualizing the change as a sequence of phases (or steps). While some authors describe change in terms of states (phases) through which the organization must pass in the process of change, others refer to actions or interventions (steps) change agents have to take in order to achieve the desired change outcome. The number of phases (or steps) identified varies from author to author and is typically three [Lewin 1947, Beckhard and Harris 1977, Schein 1987] to five [Judson 1991] phases and somewhat more steps (Kotter [1995] proposes eight-step change, Galpin [1996] speaks of nine wedges in a change wheel, while Gould [1994] identifies twelve wedges in his change wheel). It is important to notice, however, that models proposing the steps of change

actually refer to overcoming barriers to change and (directly or indirectly) identify different barriers at different phases. Thus, a mapping of steps and phases is typically possible [Armenakis and Bedeian 1999].

When such mapping was done based on a representative sample of literature<sup>100</sup> (Fig 3.9), it became clear that the differences between individual authors within the process view of change are not as significant as they might appear on the surface. Once again, different terms often denote similar phenomena. It is not surprising, then, that practitioners often follow some of the more popular models of change, but amend them by borrowing details from other models<sup>101</sup>. It is also worth noting that mapping offers an obvious possibility to integrate individual responses to change within the same change stage pattern (as discussed in 3.3.6).

A central topic in nearly all process-oriented models involves the notion that change targets will resist change. The dominant paradigm of change suggests that inertia and other factors create barriers to change, and change agents (often referred to as leaders) have to apply a combination of push and pull to chivvy change targets through the central (moving, transition) stage of change<sup>102</sup>. The reasons for barriers are multiple. As described earlier, academic literature usually ties them more narrowly to the underlying view of the nature of change (inertia due to institutional or ecological causes, if the authors come from organizational development, or human nature, if they come from organizational behavior). Normative literature usually lists a number of factors which the author finds important, often accompanied by suggestions as to how to deal with them (many of which are “tautological opposites”, i.e. change agents’ action is defined as opposite to behavior that blocks the change [Beer et al. 1990, Kotter 1995, Beer and Eisenstat 2000]).

Some of the oft-cited barriers to change include the objective and subjective losses which change inflicts on individuals [Kotter and Schlesinger 1979]. These include loss of power as responsibilities and accountabilities are shifted; loss in relationships as new patterns of interaction are demanded; loss of reward, particularly status, money and perquisites as power shifts; and loss of identity as the meaning people find in company life is threatened by change [Beer 1987]. Individuals perceive that change violates their psychological contract with the company [Hiltrop 1995, Baruch and Hind 1999]. On the organizational level, structural arrangements are also seen as a source of barriers [Hedberg et al. 1976, Miller 1982], as well as are developed core competence [Baden-Fuller and Volberda 1997], shrunken costs [Hannan and Freeman 1977], decision-making pathologies [Janis 1983], self-serving attributions [Bettman and Weitz 1983], coalition politics [Hanan and Freeman 1978], commitment to course of action [Staw et al. 1981], performance feedback misinterpretation [Milliken and Land 1991] and strategic uncertainty [Hannan and Freeman 1977, Porter 1980]. Cultural lock-in is another generally accepted barrier [Argyris and Schön 1978, Schein 1985, Heifetz 1994, Foster and Kaplan 2001]. Finally, change paradoxically resists itself: it needs to

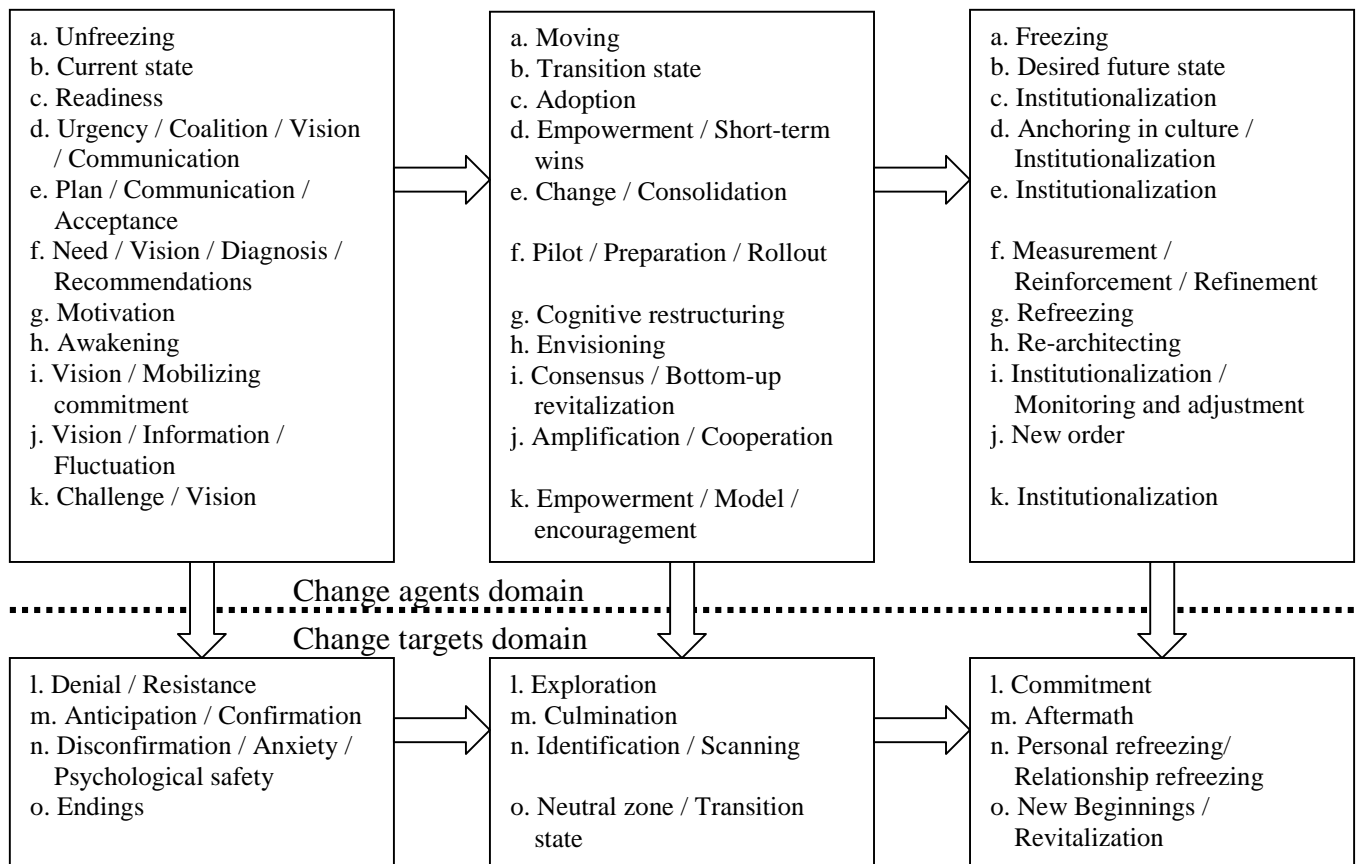
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<sup>100</sup> The literature used in Fig. 3.9 is: a. [Lewin 1947], b. [Beckhard and Harris 1977]\*, c. Armenakis et al. [1999], d. [Kotter 1995], e. [Judson 1991], f. [Galpin 1996], g. [Schein 1987]\*, i. [Tichy 1996]\*, j. [Beer et al. 1990]\*, k. [Nonaka 1988]\*, l. [Jaffe et al. 1994], m. [Isabella 1990], n. [Schein 1987]\*, o. [Bridges 1980]\*. Literature marked by \* is in addition to the original comparison made by Armenakis and Bedeian [1999].

<sup>101</sup> A good example is the description of the strategic change in Bethlehem Steel procurement [Rudzki 2001]. Authors used Kotter’s eight-step model [Kotter 1995] as a frame for change, but supplemented it with insights from Kouzes and Posner [1987], incorporated the BHAG concept [Collins and Porras 1996] to clarify the vision, and used process consulting from Carol and Jack Weber (University of Virginia).

<sup>102</sup> Note that change agents typically experience the same objective (and in many cases even the subjective) consequences of the change process, as do the change targets. The difference is in the level of active participation in the change process and the level of exhibited influence on the change outcome.

be managed, while at the same time management inhibits change; it needs committed leaders but excessive commitment may diffuse and dilute change; and it needs effective rhetoric, but rhetoric diminishes the chances of successful change [Molinsky 1997].



Source: Adapted from Armenakis and Bedeian [1999]

Figure 3.9 Mapping of change phases, change agent interventions and change target responses

The process view of change has built enough supportive arguments for the claim that understanding barriers to change in a specific situation is important for their successful removal, even though it stops short of proving causal relationships between a certain action and the success of change. Thus I find it important for understanding the changes in Croatia and Slovenia. Through the literature review I could identify no particular argument against the validity of a multi-phase view of the change process in this regional setting. Many of the barriers to change described in the literature also seem to exist in countries in transition. However, I would like to stress a major change paradox, which, based on the literature review, I assume to be particularly strong in Croatia and Slovenia, when compared to change efforts in western countries.

Fig. 3.9 clearly shows the importance most change literature attributes to vision. However, as pointed out by some authors [Lipton 1996, Hitt et al. 1998, Heifetz and Laurie 1999, Haeckel 1999, Lissack and Roos 2001], visions are not easily developed and even less easily achieved<sup>103</sup>, especially in turbulent environments. Given the extreme level of unpredictability in the environment of Croatia and Slovenia during the first phase of change, I assume that clearly articulated vision was not a major driver of change in the initial defensive

<sup>103</sup> Lissack and Roos [2001] quote Russ Ackoff in noting that fewer than 2 percent of strategic plans and their incorporated visions succeed.

restructuring there, but later became a major driver during strategic restructuring (this being consistent with previous conclusions).

Since the literature identifies so many different barriers to change, grouping them may be helpful to create a somewhat clearer picture. I propose a combination of Tichy's classification of barriers (political, technical and cultural [Tichy 1983b]) and levels of change occurrence (external, organizational, individual [Burke and Litwin 1992]). The resulting summary of barriers which I assume to be of particular importance in Croatia and Slovenia in the observed period is presented in Table 3.4. Empirical research should indicate whether these barriers truly existed, and/or whether others were more important.

|                     | <b>Political barriers</b>           | <b>Technical barriers</b>                         | <b>Cultural barriers</b>            |
|---------------------|-------------------------------------|---------------------------------------------------|-------------------------------------|
| <b>Environment</b>  | Conflicting institutional pressures | Lack of resources                                 | Conflicting institutional pressures |
| <b>Organization</b> | Leadership vacuum,<br>Poor control  | Strategic uncertainty,<br>Poor & inert structures | Lack of trust                       |
| <b>Individual</b>   | Loss of power                       | Fear of unemployment,<br>Lack of skills           | Loss of identity,<br>Denial         |

Table 3.4 Critical barriers to change in Croatia and Slovenia

### 3.3.4 Role of change agents and change patterns

Schools of thought which assume that change can be managed place the task in the hands of individuals who take the role of change agents. According to the stereotyped division of managers and leaders [Zaleznik 1977], individuals whose activities are aimed at creating change are labeled "leaders". While more comprehensive treatment of the subject of leadership falls outside of scope of this review, change management literature discusses two important aspects of leadership: traits of effective change leaders, and the actions which leaders take to facilitate, create, direct, manage and sustain change. Also, while some authors discuss individual actions or propose a few related, "most important" actions, others discuss patterns of actions and relate them to the context and content of change.

Literature on leadership behavior has traditionally been split between the notion of a universal leader who can adapt to any situation [Bass 1985, Bennis and Nanus 1985] and the concept of situational leadership [Fiedler 1967, House and Mitchell 1974, Hersey and Blanchard 1977], and has included discourses on transactional versus transformational leadership [Burns 1978, Bass 1985]. Consistent with the situational approach, many authors have suggested that managers should match the strategic needs of the firm [Wissema et al. 1980, Leontiades 1982, Gerstein and Reisman 1983]. Most authors place the responsibility for change at the top of the organization [Kotter 1982, Hanbrick and Mason 1984] and even suggest that top management should be replaced in order to facilitate major change [Friedrickson et al. 1988, Boeker 1992]. However, others claim that it is wrong to focus on the leadership acts of individuals, and place emphasis on leadership teams as key components of change [Collins and Porras 1994, Emery and Purser 1996, Landrum et al. 2000], or go to the extreme of advocating bottom-up change, with "diffused" leadership [Clarke and Meldrum 1999].

Almost independently of the above controversy, the same traits are often attributed to individuals who successfully assume the role of change agents. If we examine the list emerging from the literature, it is difficult to differentiate between some of these traits and underlying assumptions about the tasks of change agents, as implied from the list of steps in Fig. 3.9 and discussed in the next paragraphs<sup>104</sup>. A compilation of traits from the most-cited literature [Burns 1978, Bass 1985, Bennis and Nanus 1985, Tichy and Devana 1986, Kotter 1990] and from other authors who have dealt specifically with that issue [Vandermerwe and Birley 1997, Eisenbach et al. 1999, Vansina 1999, Graetz 2000, Landrum et al. 2000] shows the groups of personality attributes and skills in effective change agents presented in Table 3.5.

| Personality attributes                                               | Skills                                                  |
|----------------------------------------------------------------------|---------------------------------------------------------|
| • High energy level, enthusiasm, action bias                         | • Sense of timing, political savvy                      |
| • Competence, intelligence, knowledge of organization, holistic view | • Interpersonal skills (communication, influence, team) |
| • Need for power, ambition, self confidence                          | • Coordination skills                                   |
| • Empathy, care for people                                           | • Visioning, sense-making                               |
| • Integrity, congruent set of core values                            |                                                         |

Table 3.5 Review of personality traits and skills of effective change agents

Building on the literature review presented in Fig. 3.9 and on some additional sources [Wrapp 1967, Bass 1985, Bennis and Nanus 1985, Burke 1995, Klein 1996, Stewart 1996, Heifetz and Laurie 1997, Eisenbach et al. 1999, Floyd and Lane 2000, Beer and Nohria 2000, Graetz 2000, Landrum et al. 2000] I have compiled an overview of the most frequently suggested change agent interventions. They can be divided into two groups: interventions which take a clear direction and should be intense in order to produce an impact on change targets; and interventions the main purpose of which is to balance (manage) change paradoxes, and which therefore change in direction and intensity from time to time, and are more subtle and perceptive of intermediate changes in the environment and to organizational responses to directional interventions. Although interventions of the first type undoubtedly clear a space for change and create major movement in the organization, the second are critical to defining wider patterns of change and creating consistency among directional interventions (Table 3.6).

Investigating “standard” patterns of change has attracted a great deal of interest, and provides important insights in how context, content and process of change merge and become interdependent. This approach has its roots in the early work of contingency theorists [Lawrence and Lorsch 1967], who recognized that different structures are required in different environments. Although their studies were often contradictory and progress in the field was stymied [Mintzberg 1979], they paved the way for the work of other authors.

<sup>104</sup> Interestingly enough, some authors [Kouzes and Posner 1987, Graetz 2000] have proposed common traits even in the two seemingly very different types of leaders, transactional and transformational ([Burns 1978])



| Directional interventions                                               | Balancing interventions                                              |
|-------------------------------------------------------------------------|----------------------------------------------------------------------|
| • Giving sense to external changes / Building vision / Giving direction | • Economic value – organizational capabilities / Cost – revenues     |
| • Building political coalitions                                         | • Narrow interests – Plurality of interests                          |
| • Challenging the status quo                                            | • Loose – tight control / Creativity – discipline                    |
| • Communicating / Listening to people                                   |                                                                      |
| • Building trust / Providing a role model / Setting standards           | • Centralization – decentralization / Interdependence – independence |
| • Deploying resources / Empowering / Facilitating experimentation       | • Top-down – bottom-up                                               |
|                                                                         | • Time – space distance                                              |
| • Creating and using change monitoring and control mechanisms           | • Long-term – short-term                                             |
|                                                                         | • Universal – culture-dependent                                      |
| • Linking results and purpose / Rewarding                               | • Trust – change                                                     |

Table 3.6 Review of change agent interventions

Kotter and Schlesinger [1979] presented one of the first systematic reviews of standard approaches to change, which (to a large degree due to its simplicity and clarity of advice on deployment) became very popular among practitioners. It identified six methods of dealing with resistance to change and prescribed the fit between an individual method and the change context (Table 3.7). Kotter and Schlesinger took an extremely rational (contingent) view of change, suggesting that analysis and proper selection of change strategy (among the six models) are of key importance to the success of change. On the strategic level, this view is clearly too simplistic, since it ignores many dimensions of change (e. g., culture) on all three levels: environmental, organizational and individual. Also, some of the proposed approaches (such as the use of coercion), are highly controversial from the change target perspective, and most contemporary literature warns against the extremely high associated risks (see 3.3.6). However, if applied consistently with the other elements of the broader change pattern, the different approaches in dealing with resistance to change described in Table 3.7 have tactical value and have been repeatedly proven in practice.

Miller and Friesen [1980b], basing their work on prior research, defined 24 change-related variables and conducted empirical research on a wide database of organizational transitions. As a result, they identified nine archetypes of transition which occur significantly more often than predicted by statistical probability. Each was characterized by a different configuration of change-related variables and represented internally consistent, but mutually radically different approaches to change. Miller and Friesen [1980b] did not intend the linking of archetypes with performance outcomes as their primary research goal. However, while warning against premature optimism, they pointed out that further research might identify valid responses (i.e. those leading to better future performance) to certain types of change in a given organizational context.

In one of the most comprehensive analyses of this subject, Strebel [1992] developed the argument further and proposed eight change paths<sup>105</sup>, the choice of the “right one” depending

<sup>105</sup> In comparison with Miller and Friesen [1980b], Strebel [1992] significantly reduced the number of descriptors of change paths to scope, pace, motivation, key change agents and approach to closing the

on the balance between the forces that resist change and the change forces, as well as on how easy it is to identify the resistance forces. He also suggested that a sequence of change campaigns, each with its own change path, might be needed to deal with the varying nature of change or resistance forces. Several other studies were prepared in a similar spirit, ranging from conceptual integration of several change theories (such as research on patterns of strategic renewal [Volberda et al. 2001]), to the conceptualization of practitioner observations (e. g. change models used by major consulting companies [Denham et al. 1995]).

| Approach                     | Commonly used in situations                                                                                                              | Advantages                                                                                                                                       | Drawbacks                                                                           |
|------------------------------|------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Education + communication    | Where there is a lack of information or inaccurate information and analysis.                                                             | Once persuaded, people will often help to implement the change.                                                                                  | Can be very time-consuming if lots of people are involved.                          |
| Participation + involvement  | Where the initiators do not have all the information they need to design the change, and where others have considerable power to resist. | People who participate will be committed to implementing change, and any relevant information they have will be integrated into the change plan. | Can be very time-consuming if participants design an inappropriate change.          |
| Facilitation + support       | Where people are resisting because of adjustment problems.                                                                               | No other approach works as well with adjustment problems.                                                                                        | Can be time-consuming, expensive, and still fail.                                   |
| Negotiation + agreement      | Where someone or some group will clearly lose out in a change, and where that group has considerable power to resist.                    | Sometimes it is a relatively easy way to avoid major resistance.                                                                                 | Can be too expensive in many cases if it alerts others to negotiate for compliance. |
| Manipulation + co-optation   | Where other tactics will not work, or are too expensive.                                                                                 | It can be a relatively quick and inexpensive solution to resistance problems.                                                                    | Can lead to future problems if people feel manipulated.                             |
| Explicit + implicit coercion | Where speed is essential, and the change initiators have considerable power.                                                             | It is speedy, and can overcome any kind of resistance.                                                                                           | Can be risky if it leaves people mad at the initiators.                             |

Source: Kotter and Schlesinger [1979]

Table 3.7 Methods for dealing with resistance to change

While the proposed standard patterns of change vary significantly from author to author in almost every respect, this depending strongly on the approach taken and underlying beliefs about the nature of change, they nevertheless demonstrate that patterns do exist and that certain organizational templates and types of behavior are invoked in change situations more often than others. Although not clearly proven by rigorous research, they also hint at the conclusion that a certain pattern can systematically produce (or at least contribute to) a more effective response to a given change setting than others. All of the patterns mentioned also place a clear emphasis on both directional and balancing interventions, and suggest that while consistency and alignment are crucial for directional interventions, flexibility (including complete reversals of direction during the same change process) is key to balancing interventions.

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competence gap (including the organizational structures needed to implement change). Like Miller and Friesen, Strebel also suggested that not all combinations of descriptors are equally probable, and that some combinations have an advantage over others in a certain (external and internal) change context.

Several of the issues discussed above are, in my opinion, of utmost importance for understanding the change process in companies in transition. I have already pointed out the potential problems the literature sees in vision-driven change in highly turbulent environments. This is consistently confirmed in change pattern literature. When applying Miller and Friesen's [1980] archetypes to the local context, by far the most fitting one is T<sub>5</sub>, "Initiation by Fire"<sup>106</sup>, which clearly predicts a lack of long-term vision as one of the consequences of change.

A major research question arises as an immediate corollary of the above conclusion: what other directional intervention can be substituted for lack of vision? If vision does not act as a pull factor, can some other factor effectively replace it? In my opinion, a suggested answer, based on the literature review, is trust. The role of trust as an important, but not easily achievable<sup>107</sup> facilitator of change and a necessary precursor to reducing resistance to change has been well-presented in the literature [Hultman 1979, Odiorne 1981, Beer et al. 1990, Judson 1991, Novelli et al. 1995, Strebel 1996]. Thus, I assume that trust was the main pull factor during defensive restructuring in Croatia and Slovenia, while vision became equally important during strategic restructuring.

On the other hand, when examining the approaches to dealing with resistance suggested by Kotter and Schlesinger [1979], it is logical to conclude that time was seen as the first priority in defensive restructuring, dominating over uncertainty, while uncertainty, lack of information and the growing power of change targets became more important during strategic restructuring. This implies that explicit and implicit coercion were preferred tactics in dealing with resistance during defensive restructuring, while participation and involvement were preferred in dealing with it during strategic restructuring.

As regards balancing interventions, I find six of them particularly interesting for my research<sup>108</sup>. The economic value versus organizational capability balance [Beer 2001] is directly related to the content of change and was discussed earlier. Thus the first balance to examine is that between narrow interests and plurality of interests, which tilted progressively towards plurality. While in the first period of change cultural inertia and institutional pressures kept the interest span relatively narrow (and more narrow in Slovenia than in Croatia, where early privatization patterns created significant dissonance between new owners

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<sup>106</sup> This archetype notes that firms exposed to "great and discontinuous changes in their environments" – firms unused to forced change and with management inexperienced in the face of new circumstances – delegate power to knowledgeable people; become more innovative, but also short-term-oriented; do not develop conscious and integrated strategies; and do not make major improvements in communications and control systems [Miller and Friesen 1980b]. It is important to note that, although it is the most likely pattern for the context described, this pattern does not produce good results. Miller and Friesen [1980b] found that it yields below-average performance and depletes the firm's resources!

<sup>107</sup> A study performed by Princeton Survey Research Associates for Richard Freeman and Joel Rogers found that a trust gap often exists between employees and managers: while 54% of employees surveyed expressed loyalty to their employers, only 38% trusted them to keep their promises. The most mistrustful were minority and blue-collar workers, as well as employees in highly dynamic industries like communications and transportation [Ettore 1995].

<sup>108</sup> Although I do not claim that balancing interventions are more important than directional interventions, I find it interesting to notice that the choices involved in balancing interventions, although less open-ended than in directional interventions, are by no means easier and, as is seen in the observed companies, can actually create more controversy (i.e. while very few managers in the region disputed the need for communication during the change, endless debates went on about the level of centralization or about top-down or bottom-up tactics in a particular period of change).

on the one hand, and managers and employees on the other), in the second period the pluralism of interests increased. However, the literature predicts that this should lead to less effective change efforts [Goodstein et al. 1993, Denis et al. 2001, Golden and Zajac 2001]. Thus, I assume that growing pluralism of interest made change more difficult to achieve during strategic restructuring.

The next important issue related to balancing interventions is the decision about the level of centralization. This issue has a rich and controversial history in former Yugoslavia, and presented one of the major institutional and cultural barriers to change in situations where change required centralization<sup>109</sup>. When former Yugoslavia departed from the Soviet model of communism in the late 1940s and introduced self-management in the early 1950s, it gradually started to alter the dominant (politically prescribed) organizational model from total centralization to decentralization. This trend culminated in the Constitution Act of 1974, which defined the “Basic Organizations of Associated Labor (BOAL)”<sup>110</sup> as the titular owners of company assets. This created opposing directions in hierarchies: corporate management was placed above divisional (BOAL) management, but divisions (BOALs) owned the corporation. Decentralization as a dominant philosophy followed as a direct consequence, becoming central to the political and social identity of employees and tightly embedded in organizational cultures regardless of how cynical the employees were about other aspects of the system<sup>111</sup>. On the other hand, the literature implies that scarcity of resources and the decline of the firm result from centralization [D’Aveni 1989, Yasai-Ardekani 1989]. Thus I assume that defensive restructuring resulted in centralization.

The question of a top-down versus bottom-up pattern of change is related to, but not identical to, the issue of centralization. As noted earlier, the changes in the region created multiple problems for top-down change patterns. Many top managers were replaced due to their communist past, especially in Croatia. Of those who were not, quite a few had administrative, rather than leadership or entrepreneurial experience and personal traits. Managers with intimate experience of the market economy were extremely rare, while those with experience of similar levels of environmental change were almost nonexistent. Thus, in terms of experience even the incumbents were novices, too. On the other hand, the political system was based on a strict hierarchy, which means that a strong tradition of top-down style existed. The conclusions from the literature review presented above imply that a top-down style is seen more often in change processes with the character of defensive restructuring, while a bottom-up style appears during strategic restructuring. Empirical research should show whether a top-down style was predominant in all circumstances, or just in defensive restructuring.

Finally, the balance between a belief in the universal validity of change patterns and a belief that change patterns completely depend upon the local (and in particular cultural) context is both conceptually and pragmatically difficult. Without assuming where the balance should be, a preconceived advantage in local patterns may have been a result of management bias. Very few local scholars had a good theoretical overview of the field of change management and

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<sup>109</sup> Literature suggests this may be needed as a response to crisis [Miller and Friesen 1980b, Strebel 1992, Arogyaswamy et al. 1995], especially when slack is low and crisis threatens survival.

<sup>110</sup> BOAL corresponds to the smallest organizational unit, which is still a separate legal entity, for convenience referred to in this text as “division”.

<sup>111</sup> As noted in Chapter 2, decentralization also allowed employees to influence the very high level of benefits they enjoyed. Thus, a resistance to centralization also formed around perceived future losses in power and material benefits.

even less practical experience of it. Academics were also traditionally not viewed as sources of valuable, practical advice on management. But managers had little insight into global best practices in change management. Combined with previous conclusions about lack of learning in defensive restructuring, this would imply that managers focused on local specifics during defensive restructuring, while being more open to adopting global experience and business models during strategic restructuring.

### 3.3.5 Influence of culture on change

Individuals are part of the societal and organizational context and their individual reactions are affected by that context. Culture seems to be one of the most important elements in this context, and huge research efforts have been devoted to analyzing its impact on companies and individuals. The results are highly controversial: while some claim that culture has a significant positive impact on performance [Peters and Waterman 1982, Deal and Kennedy 1982, Kotter and Heskett 1992, Gordon and DiTomaso 1992], others indicate that culture can be both an asset and a liability<sup>112</sup> [Schein 1985, Hofstede et al. 1990] or that major performance improvements can be achieved despite negative cultural reactions to change [Lewis 1994]. Most, however, agree that culture does have a major impact on the organization, either in terms of competitive advantage (as discussed in 3.2, [Barney 1986, Fiol 1991], or as an integrating and control mechanism [Lawrence and Lorsch 1967, Argyris and Schön 1976, Ouchi 1980, Schein 1984, Pascale 1985, Pettigrew 1985, Weick 1987]. Also, many studies revealed direct effects of culture on change, both in a national and cross-national environment [Hofstede 1980, Adler 1986, Schneider 1989, Whipp et al. 1989, Hofstede 1991, Very et al. 1996]. But here findings are again controversial, some claiming that the national culture dominates over the organizational [Adler 1986], and others just the opposite [Schneider 1990, Gomez-Mejia and Palich 1997]. Finally, while most studies deal with the effects of culture on individuals, some show that organizational cultures can reflect the personality of their organizational leaders [Kets de Vries and Miller 1986].

Of the huge variety of topics briefly indicated above I will at this point focus on two which I find particularly interesting for the observed changes. The first is the influence of national culture on executive behavior and in particular on its approach to change. Hofstede's work is paramount in this field [Hofstede 1980, 1991, 1993, 1999, Hofstede et al. 1990] and is well-supplemented by many others [England 1967, Schein 1985, Hambrick and Brandon 1988, Schneider 1989, Finkelstein and Hambrick 1996, Geletkanycz 1997, Trompenaars and Hampden-Turner 1997, Breu 2001]. One interesting aspect of this influence is the link between individualistic culture and a strong (commander) approach to leadership, against that between collectivistic culture and the soft (team, clan) approach to leadership [Ouchi 1981, Pascale and Athos 1981]. This connects further with the higher level of inertia exhibited by command & control cultures [Kanter 1989, Mintzberg 1994] versus that of more adaptive clan-like cultures [Nonaka 1988, Stacey 1993], as well as the preference for discontinuous change exhibited by strong leaders versus that for continuous change exhibited by soft leaders [Hofstede 1993].

The other interesting topic is the tendency of national cultures to resist change even under high pressure [Breu 2001] and the problem this creates for "importing change" into organizations based on organizational models imported from other cultures or via cross-

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<sup>112</sup> The belief that culture is a major source of resistance to change is widely spread among practitioners, not just academics. A survey carried out by the American Management Association and Deloitte & Touche found that close to 75% of respondents saw the culture of their organization as a barrier to change [Romano 1995].

national influences (such as acquisitions). Culture clashes are common, especially where one side is expected to renounce its culture in favor of the other's [Wilkins and Ouchi 1983, Very et al. 1996, Breu 2001], and often have a highly negative impact on the organization in terms of, for example, reduced employee commitment [Buono et al. 1985], increased executive turnover [Hambrick and Cannella 1993] and resistance to necessary change [Lorsch 1986, Very et al. 1996]. Thus, an appreciation of local values, style and processes [Schwartz and Davies 1981, Lorsch 1986] and the dominant power's sensitivity to culture in the change process [Adler 1986, Bartlett and Goshal 1989] are seen as keys to a successful change of culture in cross-national situations.

Breu [2001] provided highly relevant insights into the cultural aspects of the German unification process. She not only noted that the consequences of the growing cultural divide between East and West Germany [Hessel et al. 1997] were not fully recognized [Dunbar and Bresser 1997], but she came to the conclusion through empirical research that a) the blunt strategy of forcing the West German management model onto East German companies produced extremely poor results; b) the East German companies trying to muddle through the change relying on their own forces and not significantly adapting their cultures performed somewhat better, but were still mediocre at best; and c) by far the best performance came from companies which allowed for the coexistence of both cultures by depending strongly on the capital and knowledge resources from the West, while at the same time relying on incumbent Eastern executives.

In conclusion, I interpret the predictions of the literature as follows. A high level of individualism in local culture<sup>113</sup> is likely to be linked to a hierarchical, top-down style of management. This would be helpful in the implementation of defensive restructuring in Croatia and Slovenia, but may become an obstacle to strategic restructuring. I also assume that national and company identity, as well as the pride that individuals associated with that identity, influenced both the way individuals perceived their environment, and leadership action. In practice this speaks against the use of strategic partnerships as a restructuring tool, and in favor of using challenge, rather than material rewards, as a motivator for performance.

### 3.3.6 The impact of change on individuals

While it is intuitively clear that change agents and change targets are both instrumental in the ultimate success of change, the conceptual view of change processes from the perspective of change targets has until recently received considerably less attention in the change management literature than has dealing with change on the organizational level [Nortier 1995]. Before the emergence of the transition perspective [Bridges 1980, 1986, Nortier 1995] the vast majority of research (typically in the field of psychology) involved more or less isolated effects of change, such as stress. This was despite the fact that, on the input side, individuals significantly increase the complexity of change (e.g., the variation in cultural values on the individual level remains high even in the presence of a dominant culture on the environmental or organizational level [Kirkman et al. 2000]) and, on the output side, change affects individuals within an organization more fundamentally than it does the organization as a whole [Bridges 1986, Jick 1990].

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<sup>113</sup> As another proof of the strong resilience of national cultures, a high level of individualism remains characteristic of both Slovenia and Croatia despite 50 years of pressure towards collectivism, the dominant feature of communist ideology. Croatia and Slovenia are estimated to be less similar in other dimensions of Hofstede's model [Hofstede 1991]: Croatia has a somewhat higher level of masculinity and power distance, while Slovenia has a somewhat higher level of uncertainty avoidance and long-term orientation.

This, of course, does not mean that the specific effects of change on individuals are unimportant. In particular, the threat and its resulting direct and indirect effects influence human behavior to such an extent that they deserve separate attention. This is especially important given the findings of some researchers that it is the threat associated with change that induces negative behavior in individuals, and not the change itself as some research suggests [Kanter 1985b, Adams 1986, French and Delahaye 1996, Breu and Benwell 1999]. The same is true of the perceived justice of change (especially given the high assumed importance of trust, as discussed earlier) [Cobb et al. 1995, Folger and Skarlicki 1999].

The main psychological effects of threat on an individual are stress, anxiety and arousal<sup>114</sup> [Staw et al. 1981]. Individuals under stress tend to be more hard-driven, but less flexible in their choice of problem-solving strategies, and they adhere to previously-used solutions even if they do not fit the new situation [Cowen 1952, Spence and Farber 1953]. A high level of stress also leads to reduced information processing capabilities [Menninger 1952, Withey 1962]. On the level of individuals these effects lead to rigidity, while on the group level they can decrease cohesiveness if the group perceives the situation as likely failure [Staw et al. 1981]. Apathy, a natural result of such situations, becomes a more difficult barrier to change than active resistance [Siegal et al. 1996]. Individuals also tend to display self-deceiving behavior, such as unjustified self-confidence and the illusion of being in control [Staw 1991]. It is worth noting that discontinuous change induces threat-related effects by default, because individuals cannot escape the paradox of complementary threats: if they decide not to change in order to avoid the threats related to change, they expose themselves to a potentially huge threat of losses because of not changing, to which threat they are to some degree aware [Breu and Benwell 1999].

Along with threat, perceived unfairness and violation of psychological contract are the main sources of negative individual behavior, resulting in apathy, cynicism and active resistance [Lewin 1951, Plant 1987, Cobb et al. 1995, Hiltrop 1995, Morrison and Robinson 1997, Baruch and Hind 1999]<sup>115</sup>. Change targets perceive change as unfair if the consequences are not equal for all (distributive justice [Adams 1965]); if the procedures are not consistent, free of bias, accurate, correctable and ethical (procedural justice [Leventhal et al. 1980]); and if the quality of interpersonal treatment they receive is not adequate (interactional justice [Bies 1986]). According to referent cognitions theory [Folger 1993, Brockner and Wiesenfeld 1996] individuals form expectations of standards of behavior based on past events and other sources of comparative reference, and judge fairness based on these expectations. Change agents must fulfill their moral obligation by providing adequate explanations and clearly articulating the reasons for their actions, or otherwise they “add insult to injury” (of change) [Folger and Skarlicki 1999]. A consideration of perceived justice implies, among other things, a clear need to provide change targets with additional reference points (i.e. how things will be better after change and how would they deteriorate without it [Greenberg 1990]); to create realistic expectations about change (or clearly acknowledge lack of information, when that is the case) [Schweiger and DeNisi 1991], and a need for effective use of rewarding and other HR systems [Cummings and Worley 1997]. Finally, according to Folger and Skarlicki [1999] balanced caring for all three forms of organizational justice is needed to generate a perceived fairness of change.

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<sup>114</sup> About 50% of the employees surveyed by the American Management Association and Deloitte & Touche reported frustration and stress as among the principle emotions related to the workplace [Romano 1995].

<sup>115</sup> Among other causes of negative behavior on the level of individuals, lack of trust in leaders due to historically-proven or perceived incompetence in dealing with change [Reichers et al. 1997] is prominent.

More comprehensive views of responses to change on the level of individuals propose that responses vary depending on the phase of change (Fig. 3.9). Of course, typical responses or reactions to threat or perceived injustice can be observed at any stage, but responses such as denial, anxiety, exploration or commitment are typical of specific phases [Bridges 1980, Schein 1987, Isabella 1990, Jaffe et al. 1994, Nortier 1995, French and Delahaye 1996]. Using a modified version of Nortier's five-stage model of individual transitions (equilibrium, separation, crisis, rebirth, and new equilibrium [Nortier 1995]), Breu and Benwell analyzed individual transitions on the part of East German managers [Breu and Benwell 1999]. Their findings are summarized in Table 3.8.

| Stage                           | Disintegration                                             | Euphoria                                                                                           | Crisis                                                                                                                                | Development                                                                                                      | Redefinition                                                                                       |
|---------------------------------|------------------------------------------------------------|----------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|
| <b>Environmental Perception</b> | Increasing instability and rigidity of (old) system        | Expectation of total change                                                                        | Deconstruction of the total change myth                                                                                               | Recognition of incremental realization of change                                                                 | Belief in continuity of change                                                                     |
| <b>Self-Perception</b>          | Lack of power to initiate change<br><br>Request for change | Belief in ability to achieve rapid and fundamental change<br><br>Support of change and development | Incapacity to effect change due to loss of faith in value of old skills and past experiences<br><br>Support of change and development | Learning of new concepts and building up of judgment of new environment<br><br>Support of change and development | Recovery of self-confidence and trust in own capabilities<br><br>Support of change and development |
| <b>Behavior</b>                 | Passive                                                    | Hyperactive & erratic                                                                              | Insecure & hesitant                                                                                                                   | Inquisitive                                                                                                      | Impelling                                                                                          |

Source: Breu and Benwell [1999]

Table 3.8 Transformative transition model

In addition to confirming the validity of the individual transition model, they came to a conclusion which speaks against the punctuated equilibrium model [Tushman and Romanelli 1985] and confirms the view that the revolutionary (discontinuous) phase of change ends not in static equilibrium [Nortier 1995], but in continuous change [Morgan 1986, Baruch and Hind 1999]. They also found less individual opposition to change than predicted, and explained this with the hypothesis that the threat of no change was stronger than threat of change.

The implications of the literature review as to the impact of change on individuals seem to be clear. In a defensive restructuring situation one might expect individuals on all levels within the firm to experience high stress. Their behavior would be primarily influenced by negative emotions and in particular by the fear of losing their jobs, making them more ready to accept change led by coercion. Here perceived justice and trust in change leaders would also significantly reduce resistance to change.

Based on the literature review, the main problem to be expected in strategic restructuring is the lack of a sense of urgency and perceived need for change, as well as the stress generated by prolonged periods of change.



### 3.3.7 Downsizing and turnaround as a special case of change

The last part of the literature review is devoted to a topic which in many ways represents the very core of the changes that are the subject of this study: firm downsizing and turnaround. Many studies have been conducted in this area, dealing both with the contents (in terms of chosen strategies) and the process of turnaround (both in terms of distinct stages of turnaround and in terms of change management). Many of these studies also specifically deal with downsizing as a possible (and often necessary) component of turnaround.

In principle, turnaround<sup>116</sup> strategies are needed when the firm has been suffering from an extended period of significantly-reduced performance [Schendel et al. 1976], either because it has become maladapted to the environment, the environment has become hostile, or both [Cameron et al. 1988]. The firm's existence is typically threatened in the first phase of a major turnaround. Thus, a successful turnaround can by definition be divided into two phases: decline stemming (retrenchment or defensive restructuring) and recovery (strategic restructuring) [Arogyaswamy et al. 1995].

In one of the earliest systematic studies of turnarounds, Schendel and Patton [1976] showed that the average period of decline was 6.5 years, followed by a period of recovery lasting 7.5 years. Although under conditions of increasing speed of change these stages may have shortened, they still indicate the long-term nature of both components in the turnaround process. In their study of turnaround strategies, Schendel, Patton and Riggs [1976] identified eight categories: organizational and management changes, marketing program changes, major plant expenditures, product diversification, geographical diversification, efficiency increase, divestiture and vertical integration. However, they did not link the use of any of these strategies with external or internal conditions, and they indicated that use of a combination of strategies might often be more effective than use of only one. Several other authors offered similar classifications [O'Neill 1986, Hoffman 1989, Grinyer et al. 1990, Robbins and Pearce 1992, Pelham 2000]. Also, many authors explicitly proposed that a certain type of turnaround strategic or tactical action would produce better results than another, sometimes linking this with other conditions [Harrigan 1980, Zammuto and Cameron 1985, Arogyaswami et al. 1995, Laitinen 2000, Barker et al. 2001].

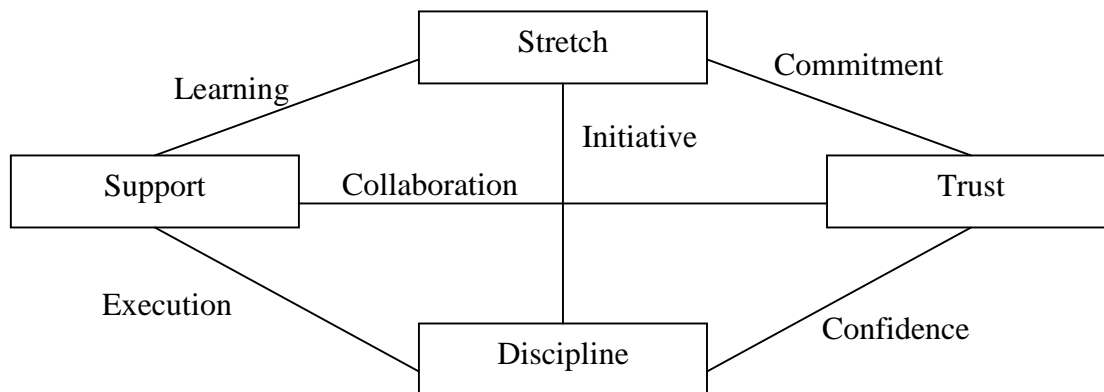
Although a firm's financial troubles are often insufficient to generate the perceived need for a turnaround strategy [Barker et al. 2001], once such a strategy is in place, its decline-stemming phase commonly focuses on increasing the firm's efficiency and on other forms of coping with financial distress [Bibeault 1982, Robbins and Pearce 1992]. Along with balance sheet restructuring strategies (such as asset divestiture), firms typically seek short-term efficiency improvements (cost reductions)<sup>117</sup> and consider downsizing their labor force. Appelbaum, Everard and Hung [1999] have presented an excellent review of possible strategies related to downsizing. They voiced the common finding that downsizing is all too often a shortsighted goal in itself and not part of an overall strategic turnaround plan, thus yielding poor results [Bruton et al. 1996]. Appelbaum and colleagues suggested that layoffs should be used as a last resort, after alternative measures have been taken e. g. reduction of headcount by attrition, early retirement and outplacement, hire freeze, work reduction or work redesign [Cascio 1993, Feldman and Leana 1994, Mishra and Mishra 1994, Mone 1994, Pfeffer 1998]. Many authors have also discussed the high cost of layoffs [Pfeffer 1998, Rigby 2002].

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<sup>116</sup> Turnaround is used in a traditional sense, denoting the process of recovery from declining performance.

<sup>117</sup> Bibeault [1982] and some other authors suggest that turnaround managers usually have ninety days or less to resolve cash flow problems once the financial crises erupts.

Researchers have pointed out the negative psychological effects of layoffs on remaining employees (called *survivors syndrome*), suggesting that negative effects can be reduced by fair treatment and support of downsizing victims and survivors, planning for the optimum strategic effects of overall turnaround, broad participation, communication, training, and reshaping of the psychological contract [Cascio 1993, Mishra et al. 1998, Pfeffer 1998, Appelbaum et al. 1999, Baruch and Hind 1999]. The paramount role of trust in building the new psychological contract is once again underlined [Bartlett and Ghoshal 1995, Mone 1997, Mishra et al. 1998]. Bartlett and Ghoshal [1995] proposed a simple model of factors that can support the building of new individual behavior (Fig. 3.10). These factors balance and reinforce each other, and in pairs produce the desired organizational effects.



Source: Bartlett and Ghoshal [1995]

Figure 3.10 Management context and organizational behavior

Replacement of the top management team is often considered one of the actions forming part of a turnaround [Slatter 1984, Barker et al. 2001], especially in the case of external control of the firm. However, researchers remain divided about its effects. While some suggest that top manager replacement may be a form of adaptation, and that benefits will stem from an infusion of fresh ideas, a new understanding of the environment, improved competence and credibility [Slatter 1984, Barker et al. 2001], others claim that many factors influence the effectiveness of replacement [Friedrickson et al. 1988, Breu 2001]. Inconsistent research findings on the impact of top management replacement on firm performance [Puffer and Weintrop 1991] have also contributed to the lack of clear conclusions in the literature.

Successful implementation of decline-stemming strategy cannot focus merely on issues related to balance sheet and cost restructuring, but must serve at least two more purposes related to ensuring survival and laying the foundations for revival: renewal of stakeholder support, which is likely to deteriorate due to decline and harsh decline stemming measures; and stabilization of the internal climate and decision-making processes [Arogyaswamy et al. 1995]. Once these goals are reached, the recovery stage can begin and recovery strategies can be used. Arogyaswamy and his colleagues [1995] claim that the choice of recovery strategies depends on the reasons for the decline and on the firm's competitive position. Particularly interesting is their suggestion that firms with a weak competitive position who face declining markets should scale back to core customer segments and create new resources and capabilities to serve them. This concurs with findings from other studies which suggest that a focus on core activities and investment in customers, marketing and new product development will increase the chances of successful recovery [Grinyer et al. 1990, Dawley and Hoffman 2000, Laitinen 2000].

Since the reviewed literature places limited long-term value on asset restructuring, and given the low liquidity of asset markets in Croatia and Slovenia in the first period of change, I assume that turnaround strategies in Croatia and Slovenia had little benefit from asset restructuring.

The literature suggests that downsizing issues are very important, and that the trust associated with clear communications and hope in recovery has a significant impact on the success of defensive restructuring.

The literature does not resolve the controversy over CEO and top management team replacement in a turnaround situation. It implies, however, that the perceived competence of and the trust which key stakeholders place in incumbent management takes precedence over other factors. This is in line with suggestions concerning the multiple targets of the decline-stemming phase, as well as being appropriate to the long duration of turnaround processes; both of which factors lead to the conclusion that communicating the need for turnaround to key stakeholders and maintaining their trust over a prolonged period of time is a necessary precondition for successful turnaround.

Finally, based on the literature reviewed, I suggest that a focus on core activities and investment in distribution channels, marketing and new product development comprise the most effective recovery strategy to be implemented in the strategic restructuring phase.

### **3.4 Research model**

The researcher building a research model in the area of strategic change management faces several challenges. The first is the size and complexity of the model. If the ambition is to create a model that describes multiple dimensions of change, and if it is to be concrete enough to be useful in describing or predicting change outcomes without further model refinement, complexity is unavoidable. However, complex models are more difficult to verify, and practitioners can also find it too difficult to apply normatively.

The next major challenge is the level of reliance on the existing literature. Ideally, the model should rely heavily on findings from previous research, and critically integrate key components from existing “theoretical building blocks”. However, the results of a fairly broad literature review performed in this chapter are often controversial, thus bringing up additional questions. In many instances individual theories contradict each other in their fundamental views on competitiveness and change phenomena. This becomes even more obvious when translating the conceptual views suggested by a theory into a model describing or predicting change events and outcomes. Finally, when discussing complex and controversial issues, even the most self-evident assumption can be viewed as subjective and requiring verification.

#### **3.4.1 Main research question**

From the examination of issues related to competitiveness and to strategic change management as described in the literature it becomes clear that strategic change is a complex phenomenon which can be examined from different perspectives. No dimension of change can be ignored if it is to be understood. It is also clear that it is not easy to achieve a positive change outcome, since barriers to change exist at different levels. In order to influence the change outcome, change agents can intervene in many ways, and success is unlikely if these interventions are not coherent, appropriate and comprehensive.

There are several general models of strategic change in the literature. Few have endured the scrutiny of a number of reviewers or, based on the brief review done in this chapter, seem to be acceptable in the observed context. The most notable examples are three concepts, two proposed by Pettigrew and one by Burke and Litwin. Pettigrew made a strong case for looking at change from political, technical and cultural perspectives [Pettigrew 1973, 1985, 1988], and also took into consideration the context, content and process of change [Pettigrew 1987, 1988, Whipp et al. 1989]. Burke and Litwin, in constructing their model of change, mirrored the thinking of many other authors and looked at change-related phenomena on the level of the environment<sup>118</sup>, the organization and individuals. Unfortunately, although in principle acceptable, none of the general models is detailed enough to offer direct and explicit answers to questions asked by practitioners.

As noted before, detailed models of change are either limited in scope, addressing one or a few aspects of change-related phenomena (e. g., Kotter [1995]); typically do not propose content (i.e. do not discuss strategy and resource-related issues); or do not pass even a basic test for applicability in the observed context [Vollmann 1996]. This clearly indicates the need to extend one of the existing general models of change, or to construct a new one with both the power of treating change as an integral phenomenon, and the necessary level of detail.

In practice, managers must address all aspects of change. They have to make sense of signals from the context, and analyze, decide and act in real time, since both the outer and the inner context in which they operate are constantly changing. They have to find answers, but are often handicapped by a given organizational template which for one reason or another has become inappropriate in the context, and sometimes the gap that has opened is huge. While closing this gap they must work within the constraints of limited resources, and deal with numerous barriers to change. Even within a gradually-changing context the task is not easy; and when the scope, amplitude, speed and rhythm of change reach a crescendo, the task becomes absolutely formidable.

It is difficult to clearly define a successful outcome of change. The starting positions of individual firms or even units within a firm can be very different and, given the relatively small size of the economies observed, it is practically impossible to find a significant sample of comparable cases to make meaningful comparisons. In the situation of discontinuous change even more fundamental performance-related questions arise, such as those regarding the true and perceived nature of the firm and its basic objectives. If the institutional pressures in one period set the social value the firm generates as the highest goal, while in some other period economic rent becomes the only criterion of success, how can one set consistent and precise determinants measuring the success of change? Also, if measurement is not carried out in a controlled environment and, given deficiencies in infrastructure, strongly depends on subjective estimates of the very actors of change, how can one avoid skewed results? Last but not least, given the complex nature of change-related phenomena it is close to impossible to verify causal relationships among the numerous factors which a complex model assumes to influence change.

All these reservations notwithstanding, the **central question of this research** remains the same: **can patterns be identified in the change-related phenomena in the observed companies in Croatia and Slovenia which would allow the construction of a model of**

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<sup>118</sup> The environment corresponds to what Pettigrew refers to as “outer context” [Whipp et al. 1989].

### **strategic change explaining the behavior and change outcomes in the period of observation?**

Answering this question will enrich our understanding of change-related phenomena in general, in countries in transition and situations of discontinuous change in particular. It will also help practitioners (managers, consultants and business school faculty) to improve their effectiveness in dealing with change.

#### **3.4.2 General model of strategic change management**

The research model is aimed at studying strategic change management in the observed companies in Croatia and Slovenia. Its main purpose is twofold: to propose a universally valid model of strategic change management, and to serve as a frame for defining detailed research questions. The model presented in Figure 3.11 consists of several basic building blocks, each of which will be explained in more detail in the following paragraphs. Although the model is presented in a general form, one of its main contributions is that the building blocks can also be translated into a context-dependent form to explain the observed change phenomena in Croatia and Slovenia. It should be noted, however, that despite the fact that the model borrows the phase concept from the models presented in 3.3.3, it brings them closer to the models of Pettigrew and Burke and Litwin presented in 3.3.2. The context and content considerations of strategic change management are crucial in the trigger and design phase, while process considerations dominate the implementation phase. However, all three groups of considerations are to some extent present in all three phases.

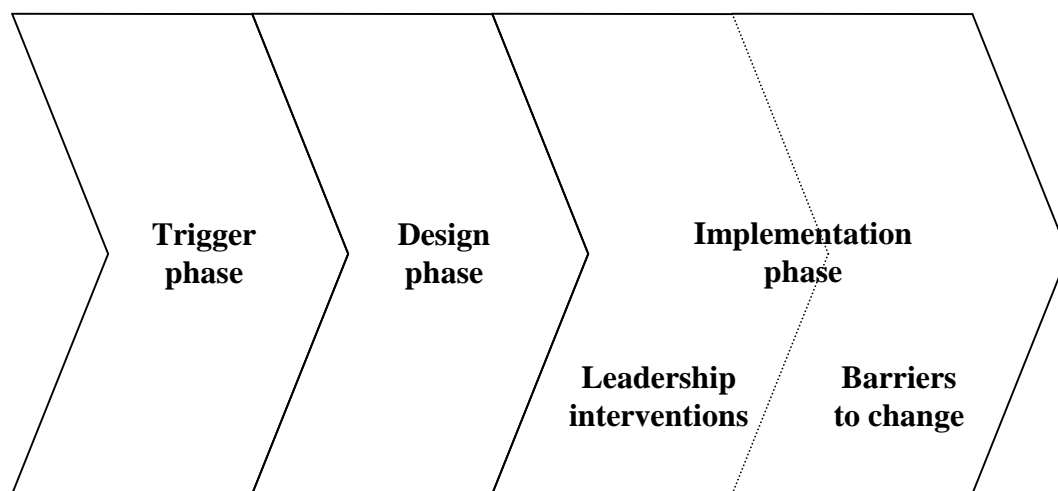


Figure 3.11 Model of strategic change management

##### **3.4.2.1 Trigger phase**

The existence of a trigger phase implies that change agents constantly assess a number of factors and, based on their assessment, either engage in designing a new organizational template and implementing new design through a set of leadership interventions, or stay in the assessment loop without additional activities. The simple model of the trigger phase is presented in Figure 3.12.

While this model is not new, it raises the issue of the criteria which change agents use to assess the need for and feasibility of change. Based on the literature review, and in particular

on the conclusion relating the literature review with the observations from Chapter 2, I have identified the following major factors influencing the assessment:

1. Institutional pressures (chapter 3.1.7), in particular social issues and the question of the purpose of the firm (3.1, 3.3.3); industry practices and mimicking (3.1.8, 3.2.2, 3.3.1); cultural pressures (3.3.5);
2. Transparency of performance (3.1.5);
3. Opportunistic behavior (3.1.5), although the research should show whether it led to a higher or lower rate of change attempts;
4. Sufficiency of critical resources (3.1.6), in particular the role of trust-inspiring leadership (3.3.4, 3.3.5, 3.3.6, 3.3.7), as well as the unclear role of financial slack (3.1.6), the effect of which on a higher or lower rate of change attempts the research should indicate.

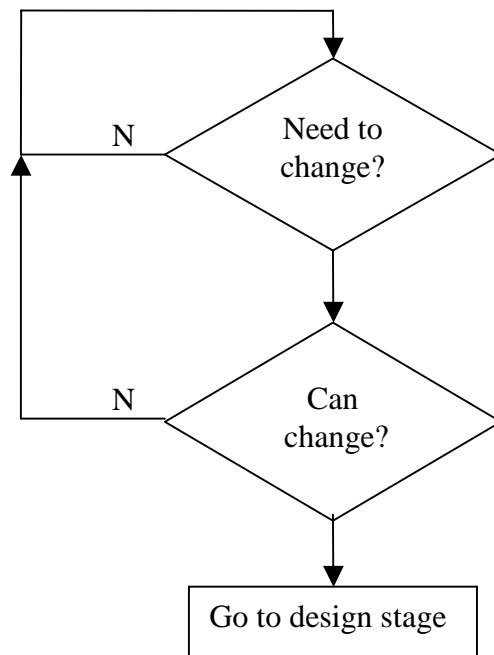


Figure 3.12 Model of the trigger phase

Staying in the trigger phase for a prolonged period of time despite a growing lack of fit between the context and the organizational template would, according to the literature, lead to degradation of performance and eventual demise (3.1.8, 3.2.2, 3.2.4).

It is important to stress once again that the influence of the factors listed above is not and should not be based on their measurable, objective and true nature, but on the way they were perceived and interpreted by the top management group, who, based on the literature review, are identified as the most important stakeholders initiating the change process, since only they had the true power to perform the redesign of the organizational template (i.e. set of strategies, organizational structures and systems) necessary for the next phase of change.

#### 3.4.2.2 Design phase

Once the top management sensed the trigger for change, it engaged in designing the organizational response to change. Based on the literature review I propose a model of the design phase, presented in Figure 3.13.

The literature implies that the new design the top management group was likely to consider as the result of their interpretation of the environment would depend on both the perceived feasibility of the reaction to change and the perceived time available before the change in the environment would bring the firm down (3.1.8, 3.2.2). If the urgency and feasibility perceived did not lead to a redesign of the organizational template, the change process would be stalled and the firm would stay in the trigger phase of the change (area “1” in Figure 3.13).

The literature also suggests that in cases of great perceived urgency of change, defensive restructuring was the firm’s likely response (3.2.2, 3.2.3, area “2” in Figure 3.13). On the other hand, in cases of less perceived urgency and greater perceived feasibility of change the firm was likely to respond with strategic restructuring (3.2.2, area “3” in Figure 3.13).

In case that the perceived urgency and feasibility of change would be sufficient to start the change, but not to invoke defensive or strategic restructuring, the firm’s likely response would be non-aligned changes (area “4” in Figure 3.13)

The literature also indicates a likely sequence of events: since defensive restructuring would be unlikely to create sustainable competitive advantage, further strategic restructuring would be needed (path “A” in Figure 3.13) or else companies would find their change process stalled and would gradually return to the trigger phase (3.2.2, 3.1.1, paths “B” and “C” in Figure 3.13).

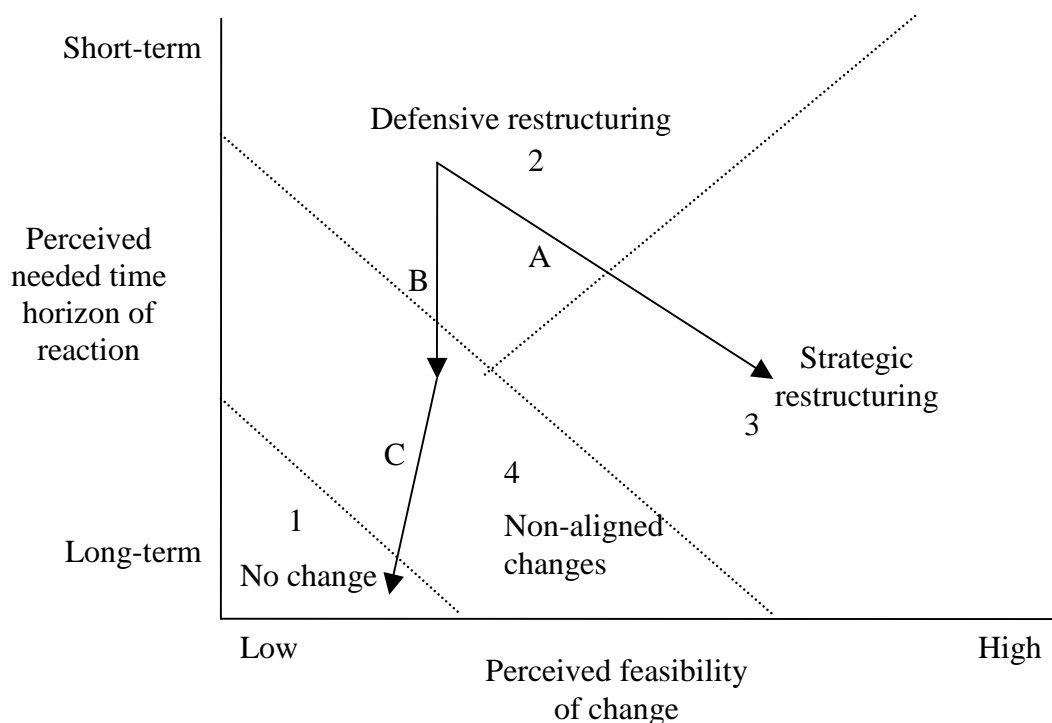


Figure 3.13 Model of the design phase

The term “defensive restructuring” is used in the above model to mean the various forms of corporate response to performance decline [Sudarsanam and Lai 2001], aimed at stemming it [Arogyaswamy et al. 1995], which typically focus on short-term improvements of cash and cost position in order to cope with present or potential financial distress. The term “strategic restructuring” is used to denote recovery strategies aiming to position the firm to better

compete in its industry [Arogyaswamy et al. 1995], which typically focus on long-term competence improvement. The term “non-aligned change” is used to denote a set of changes which lack a clear common strategic goal. The fact that the concept of non-aligned changes is not directly matching restructuring models known from the literature should not be taken against it. While literature deals with well defined models of restructuring, it is logical to expect that some designs of the organizational templates are not internally consistent. Non-aligned changes refer to those designs, which were deficient due to weak signals about the desired nature of change, and are built without a clear strategic pattern.

The dotted lines in Fig. 3.13 denote the borders between individual areas. The interpretation of the conclusions from the literature suggests that the borders are not sharp, but rather roughly indicate the zone in which characteristics of change gradually transit from one mode of restructuring to another.

The defensive and strategic restructuring referred to in Figure 3.13 should not be confused with the two phases of change in Croatia and Slovenia described in Chapter 2, since the latter describe events on the level of the national economy, while the former concepts apply at the company level. Nevertheless, they are closely connected, since most of the defensive restructuring took place during the first phase of change, and most of the strategic restructuring during the second phase. The trigger phase of the research model explains why some companies were late with defensive restructuring or passed directly to strategic restructuring, thus blurring the picture on the macro level.

#### 3.4.2.3 Design details and the implementation phase of defensive restructuring

The literature predicts that defensive restructuring was one possible reaction to the change trigger. It is worth detailing its predictions concerning the nature of the reaction and in particular the characteristics of the firm’s resulting strategy; the key resources to be deployed in achieving the results of the change; and the process of change in terms of leadership intervention and barriers to change.

One of the key predictions of the literature is the absence of vision and strategic intent in the defensive restructuring of firms in Croatia and Slovenia in the observed period (3.3.2, 3.3.3). While this statement has no value label attached to it – i.e. it does not imply that firms were more or less successful in handling the change process and achieving the goals associated with defensive restructuring – it has many important consequences, which will be discussed in Chapters 5 and 6.

According to the literature review one would expect the key design elements of the new organizational templates involving defensive restructuring to be:

1. Attempts at asset restructuring (3.3.7) (however, the literature assigns limited effects to asset restructuring in the context of defensive restructuring);
2. A focus on cost reduction and in particular on workforce downsizing (3.1.8, 3.2.2, 3.3.7);
3. Centralization (3.3.4);
4. A focus on local specifics rather than a global perspective (3.3.4).

The literature review implies that the following resources were of major importance for defensive restructuring in the companies observed:

1. Financial slack (3.1.6), as well as other possible extraordinary sources of economic rent such as monopolies (3.1.2) or institutional links (3.1.7);



2. Rational internal control systems allowing for transparency of performance (3.1.5);
3. Optimal use of existing human talent, in particular scarce middle management (3.2.4);
4. Trust in leaders (3.3.4, 3.3.5, 3.3.6, 3.3.7) and the belief that the firm can survive (3.3.7), which employees shared;
5. Leadership (3.3.2) providing interventions as described below.

According to the literature review, the main leadership interventions during defensive restructuring were:

1. Top-down decision-making about new elements of organizational template (3.3.2, 3.3.4) and aligned deployment of scarce resources (3.2.2);
2. Communication with employees (3.3.7), primarily aimed at building trust (3.3.4, 3.3.5, 3.3.6, 3.3.7) and hope (3.3.7), as well as managing fear (3.3.6);
3. Balancing coercion (3.3.6) and communication to secure fast implementation.

The literature review also implies that the change imposed by defensive restructuring faced some barriers, which are summarized in Table 3.4 (3.3.3). Comparing them with the factors affecting change during defensive restructuring, as described above, and after eliminating tautologies (e.g. lack of trust mentioned as a barrier to change and trust identified as a key resource), the literature predicts that strategic uncertainty, poor structures and skills, and fear (particularly of unemployment) would have been the main barriers to successful implementation of new organizational templates during defensive restructuring.

Finally, closely related to the notion of resources, is another prediction from the literature: that the observed companies involved in defensive restructuring were suffering from poor organizational learning (3.3.1, 3.3.2, 3.3.4), which limited the development of new strategic resources. An important indirect consequence of this consideration is that the absence of learning and lack of vision constituted two major barriers to the transition to strategic restructuring once the immediate goals of defensive restructuring had been reached.

#### 3.4.2.4 Design details and the implementation phase of strategic restructuring

The research model presented in Figure 3.13 proposes strategic restructuring as the alternative response to the change trigger. The literature review suggests a critical difference in the nature of strategic, as opposed to defensive restructuring. Strategic restructuring by its nature requires significant time for completion (3.2.2), which is why it was not a likely alternative in cases of perceived urgency of change. The literature also implies that strategic restructuring requires a high level of ambition and an articulated vision for the firm (3.3.2, 3.3.3).

Based on the literature review I assume that the key design elements of the new organizational templates related to strategic restructuring were:

1. Clear strategic positioning with regard to low cost or high value as the principle source of competitive advantage (3.1.8, 3.2.2, 3.3.7);
2. Focus on business units, elements (activities) within the value chain and products aligned with the strategic position (3.3.7);
3. Global perspective as a source of learning and, in particular, benchmarking and new design ideas (3.3.4).

The literature review implies that all of the resources identified as important for defensive restructuring in the companies observed were of equal importance to the strategic restructuring, but three new major resources were added to the list:

1. Financial slack (3.1.6), and other possible extraordinary sources of economic rent such as monopolies (3.1.2) or institutional links (3.1.7);
2. Rational internal control systems allowing for transparency of performance (3.1.5);
3. Optimal use of existing human talent (3.2.4);
4. Trust in leaders (3.3.4, 3.3.5, 3.3.6, 3.3.7) and the belief that the firm can significantly excel (3.3.7), which employees shared;
5. Leadership (3.3.2) providing interventions as described below;
6. Flexibility in reactions to change (e.g., rapid new product development) (3.2.3, 3.3.7);
7. Stakeholder (in particular customer) intimacy (3.3.7);
8. Time (3.2.2, 3.3.4).

According to the literature review, the main leadership interventions during strategic restructuring were:

1. Top-down decision-making on new elements of the organizational template (3.3.2) balanced with bottom-up change management (3.3.4);
2. Communication with employees (3.3.7) primarily aimed at communicating the vision (3.3.4) and building trust (3.3.4, 3.3.5, 3.3.6, 3.3.7), as well as managing stress (3.3.6);
3. Building participation (3.3.4) to secure fast implementation.

Findings from the literature reveal a growing pluralism of interests (3.3.4) and change fatigue (3.3.6) as main barriers to successful implementation of new organizational templates during strategic restructuring, along with the remainder of the barriers mentioned in defensive restructuring.

### 3.4.3 Detailed research questions

While the main research question reflects the principle objective of the research as defined in Chapter 1, it clearly requires refinement in order to serve as the basis for field research. The most natural way to approach the detailed questions is to follow the structure of the research model and investigate how individual building blocks apply in the observed situation.

Q1. Which factors influenced the perceived need to change? In particular, which factors influenced the perceived necessary time horizon for action?

Q2. Which factors influenced the perceived feasibility of change?

Q3. What was the pattern of response to the perceived time horizon for action and the perceived feasibility of change, if any? What was the sequence of responses?

Q4. If defensive restructuring was one of the responses, what was its nature? What were the key elements of the new organizational template? What were the key resources needed? What were the main leadership interventions used during implementation, and the barriers to successful implementation of the new template?

Q5. If strategic restructuring was one of the responses, what was its nature? What were the key elements of the new organizational template? What were the key resources needed? What were the main leadership interventions used during implementation, and the barriers to successful implementation of the new template?

## **4. Research methodology**

Two phases were instrumental in preparing the field study: the choice of research strategy, and the definition of field study protocol. Both are presented in detail, together with some considerations as to the limitations of the approach taken. The methodology used to calculate the point values in “perceived urgency of change – perceived feasibility of change” diagrams is presented in the final part of the chapter.

### **4.1 Research strategy**

An appropriate research strategy had to be chosen to find answers to the research questions defined at the end of Chapter 3. The subsequent research had to match the nature of the very clear research questions, i. e. they had to have a sharply defined focus, and also provide for validation of results [Yin 1989].

#### **4.1.1 Choice of research methodology**

Although the research questions focus on “what”, they also inherently raise the issues of “why and how”. The research study had to be designed to answer those questions and verify the new research model based on the literature review. However, along with the goal of verification, the study had to be of an exploratory nature, since the model is a new construct and allows for refinement and extensions.

The focus of the research had to be defined both in terms of time dimension and the subject of study. While the research questions as such do not specify the time period, the objectives stated in Chapter 1 clearly define the period from 1991 to 2003 as the period of observation. The initial choice to focus on companies from Croatia and Slovenia not only defines the geography, but also influences another choice of focus: given the fact that even the largest companies which were possible research targets had fairly simple, flat structures, focus was aimed at the corporate level even for companies with business units. It should be noted, however, that such a choice does not omit observations made at lower levels of the hierarchy (or structure), but merely defines the top level as equivalent to the management board of the corporation.

The research model is built around the notion of interdependence of change context, content and process. More specifically, it looks at the organizational template (the set of factors including strategy, organizational design, organizational systems and various resources) as the content of the change, while leadership interventions (including use of organizational systems) mark the process of change. From the nature of the research questions it emerges that the observations had to focus on various elements of corporate life, such as events, resources, intended and declared strategies, and realized ones, or the observable behavior of people. However, observations also had to provide evidence concerning less tangible phenomena, such as management assessment of certain situations. Therefore, to yield enough information for subsequent analysis, the research methodology had to facilitate the making of both categories of observations from a historical perspective.

The case method was chosen as the most appropriate research method for this particular situation. There are several reasons for this. A qualitative, rather than a quantitative approach was taken, both because of the nature of the questions requiring in-depth observations and interpretation, and because of the relatively small sample of companies available for the

study. Previous discussions of qualitative research methodology reveal cases as adequate tool for research both into topics involving the resource-based view as the starting paradigm for analyzing strategy contents, and into topics surrounding organizational behavior and change management processes, which come close to traditions of research in the social sciences [Yin 1989, Zahra and Pearce 1990, Rouse and Daellenbach 1999, Denzin and Lincoln 2000].

The case method as it was incorporated in this research also allowed for the combining of low and high intrusion research methodology. Each has its advantages: high intrusion is necessary for a more in-depth understanding of the observed phenomena [Schein 1985], but it influences the behavior of the subjects under its scrutiny. This can happen both during the course of events under observation (e.g. when the researcher acts as consultant to the management group being observed), or during the process of reconstruction of events after time has elapsed (e.g. when the researcher conducts an interview and asks questions about a particular event). Constructing a case study can to a significant extent validate the data through the use of triangulation [Stake 2000].

While case studies were the chosen format for presentation of the research material and findings in this study, material was collected according to seven different methodologies, as described in the research protocol. Once collected, it was checked for consistency, and subjective claims not confirmed by at least two methodologies (not just more sources within the same methodology) were rejected. This rendered the remaining subjective claims much more robust and suitable for analysis along with the factual data.

In the course of this research, case studies have been used in such a way as to combine fact-based storytelling (the objective approach) with explicit reflections on learning from these stories (the assertive approach). This combination of approaches leads to the building up of knowledge from the case studies which is in turn used to confirm or reject various elements of the research model as well as to add new elements to it.

#### 4.1.2 Selection of case studies

Given the exploratory nature and multiple focus of the study, the choice of multiple instrumental case studies appears logical [Herriot and Firestone 1983, Yin 1989, Stake 2000]. There is an important question here, however: that of which companies to select. Eisenhardt [1989a] proposes that the choice can be justified by statistical or theoretical arguments, but that random statistical sampling may not be the best approach for cases which aim at theory-building. Because of the small sample of potential targets and the decision to use a small number of in-depth studies, as well as the novelty of the constructed theoretical model, theoretical arguments take precedence over statistical in this field study. Therefore criteria had to be defined which would provide the best match between the cases selected and their intended tasks.

The first criterion to be used to achieve the desired level of depth of observation and subsequent analysis is accessibility. Not only should the companies in question agree to participate in the study, but also material, collected by different methods, should be available. In particular, the researcher should be truly familiar with the company in order to be able to interpret the observations made, and he/she should have direct access to all hierarchical levels in the company, including the top management and the supervisory board.

The second criterion is the opportunity to learn. All the companies selected should reflect for observation as many different phenomena related to the research model as possible.

Furthermore, they should present the potential for exploration of causal links as well as complexities related to multiple phenomena. This also means that companies undergoing only one or two change cycles during the entire time period, and experiencing events which have simple causes (e.g., a permanent no-change situation due to extremely poor leadership and the influence of one powerful stakeholder) would be less preferred targets than companies with richer stories to tell, from which more insights may be gleaned.

The third criterion is that of representation. Selected case studies should have a generalization potential, facilitating conclusions that fulfill the research objective not only by validating the research model, but which are also useful for practicing managers. They should represent a deliberately selected spectrum of variations (e.g. in industry setting, company performance etc.), which can be narrow in some dimensions and wide in others. In this particular study it was decided to apply the following requirements in this context: research should focus on companies regional in their sales, large by local standards but not on the same order of size as the leading international companies in their industries, and from various manufacturing industries (with both consumer and industrial market-oriented companies represented).

Given the narrow choice, it was also attempted to provide cases with at least some polarity of performance. A comment is needed, however, on the use of polar examples (i.e. pairs of companies which share all the structural attributes of industry, size, markets etc. but differ one from another significantly in terms of performance). This has become a highly popular approach in studies using multiple case studies, since, if properly applied, it may lead to a theory involving the factors which influence difference in performance [Kotter and Heskett 1992, Collins and Porras 1996]. While the strict use of polar pairs was considered in the initial design phase of this research, it was dropped for two main reasons. First of all, the companies in the region that were truly negative performers in the early stage of change went bankrupt within a fairly short period. They represent an almost trivial illustration of a limited number of factors which negatively influenced the outcome of change, and thus offer fairly limited learning potential – plus very low accessibility, since most of their records, except for media sources, were subsequently lost. Even tracing witnesses would require huge efforts with potentially limited outcomes, since there would be almost no way to validate their statements.

For those companies which survived, it was difficult to make a clear-cut division into high performance versus low performance cases. On the one hand, in some periods of observation key stakeholders did not necessarily define performance criteria according to traditional measures of financial performance, and thus it seemed unreasonable to compare companies by financial performance criteria alone. Furthermore, in some periods the financial reporting of some companies was so inaccurate that accessible data cannot be used as a reliable basis for comparison. On the other hand, almost all the companies within the broader target group showed significant oscillations in performance throughout the period of observation. Since no point of stability has so far been reached, fixing any time mark for performance comparison may cause significant aberrations in conclusions given the difference in change cycles among the companies in the sample.

On closer examination one can see clearly that the above criteria are not fully independent of one another. Low accessibility has a high likelihood of reducing opportunities to learn, and the same is true for low representation. However, the opportunity to learn is not a direct consequence of the other two criteria and was for that reason introduced as a separate one.

On the basis of the above criteria, twelve companies were selected from a group of about forty which had been identified through initial screening as the broader research target group. Letters were written to the CEOs of each of the twelve companies describing the study and asking for the company's participation. Follow-up conversations provided further clarification and were used to solicit cooperation more actively. One out of the twelve companies refused to participate, while another two effectively eliminated themselves by not creating the expected level of accessibility. Of the remaining nine companies, two were eliminated after a detailed review of the collected material, based on the second criterion. The remaining seven companies fulfilled all three main criteria, and case studies were developed describing each of them.

## **4.2 Field study protocol**

The field study is based on seven principle methods of data acquisition. Two of these are based on publicly-available documents: annual reports and other company documents in the public domain such as web pages, and newspaper articles (three main collections were used: Delo and Gospodarski Vestnik in Slovenia, and Vjesnik in Croatia).

The next two major sources of data came from two different types of consulting activities. The first comprised reports on study projects prepared within the framework of various IEDC – Bled School of Management courses, in particular the Presidents' MBA Program, the Executive MBA Program and the General Management Program. While project methodology differed in its details from one program to another, all shared several conceptual similarities. All were prepared by the program participants, and all of the participants were managers with 7 to 15 years of business experience on average (depending on the program). All the projects were prepared under the supervision of IEDC – Bled School of Management senior faculty, who worked closely with the researcher. They all followed a sequence of first preparing an industry analysis, then a company analysis, while the last part of the project was dedicated to analyzing and proposing a solution (including implementation details, qualifying them for the category of consulting projects) to a strategic issue facing the company. All the projects were presented to the company's senior management. Out of more than 500 projects prepared in the school in the period of the research focus, more than 70 were prepared for the companies selected for the study. At least three projects were prepared for each company, with a maximum of more than 20 prepared for one company.

The other type of consulting activity comprised personal consulting assignments on the part of the researcher, typically in the capacity of personal advisor to a CEO, or in some cases to the Supervisory or Management Board or one of their members. The type and timing of assignments differed, but again all seven companies were covered. These activities were not aimed at generating data for the research, but observations arising from them were extremely useful for the field study.

The fifth source of data was the set of teaching cases written at the IEDC – Bled School of Management under the supervision of the researcher. A final text with enclosures as well as all the materials collected in case preparation were available.

The sixth and the most important source of data was a set of structured interviews carried out by the researcher and three research assistants. All interviews consisted of a standard group of questions, which closely followed the research questions with minor changes in formulation for better clarity. Additional questions were prepared for each interview based on the analysis of the previously-collected data and an understanding of the specific situation. These

questions were typically aimed at obtaining detailed anecdotes about specific events, detailed accounts of the reasoning behind certain decisions, etc. Six to twelve interviews were made per company, depending on its size. The total number of interviews was 62. All or at least the majority of management board members as well as several representatives from the middle management were interviewed in all companies, while in some cases members of the Supervisory Board, front-line employees and ex-employees were also interviewed. Use of multiple interviewers allowed for creativity and enhanced confidence in converging observations.

Finally, the seventh source of data was the feedback received from a number of senior managers, who read the draft case studies and provided ample comments. This in turn improved the reliability of the research findings. In particular, the following individuals helped with a review of the text of the research cases: Gorenje: Mr. Franjo Bobinac, President of the Management Board and Mr. Primož Sovič, Director of Logistics; Kolinska: Mr. Miro Hrovat, Management Board Member and Mr. Iztok Bričl, Management Board Member; Končar: Mr. Darinko Bago, President of the Management Board and Mr. Vlado Plečko, Management Board Member; Lek: Mr. Marko Podbevšek, Management Board Member; Ljubljanske mlekarne: Mr. Matjaž Vehovec, President of the Management Board and Ms. Jana Lenič, Executive Director for Strategic Business and Processes; Lura: Ms. Nina Anđal, Management Board Member; Podravka: Mr. Darko Marinac, President of the Management Board and Mr. Damir Polančec, Management Board Member.

It is worth noting that both qualitative and quantitative data were collected. Thus, although the study has the attributes of qualitative research, on the data level quantitative data was used to validate some qualitative statements, as suggested by Eisenhardt [1989a].

Another interesting methodological point is the use of the “devil’s advocate”, an independent expert with significant experience in the transformation processes in and outside of the region, who was asked to go through the preliminary findings and raise issues which he found questionable.

The study was conducted according to the following research protocol:

1. Collection and screening of data from public sources;
2. Collection and screening of data from consulting reports;
3. Collection and screening of data from teaching cases;
4. Preparation of the customized part of the interviews based on prescreened data;
5. Structured (standard and customized) interviews;
6. Analysis of findings from the interviews;
7. Report on findings and conclusions from individual interviews;
8. Preparation of individual cases;
9. Cross-analysis of the cases and preparation of draft conclusions;
10. Presentation of the preliminary findings to the “devil’s advocate”
11. Presentation of individual cases to the related companies;
12. Finalization of the cases based on feedback from the companies;
13. Finalization of the conclusions.

According to Yin [1989], four tests should be applied to a case-based research design to check design quality: construct validity, internal validity, external validity and reliability. The construct validity check verifies whether the elements of the research model and their mutual links have been studied in a correct way and whether their presence has been appropriately

measured. The internal validity check looks at the way the conclusions have been derived from the observations, and confirms causal relationships. The external validity check is concerned with the generalization potential of the results and the appropriateness of research conclusions in that respect. Finally, the reliability check verifies that the research results are not of an accidental, singular nature, but can be reached again were the study repeated under the same circumstances.

Table 4.1 shows the application of the research design quality tests described above to the study. It proposes that the chosen research strategy and the research protocol developed satisfy the test criteria proposed by Yin [1989]. Although not all of the tactics proposed by Yin were used, each of the tests was supported by appropriate research design.

| Test               | Research design choices                                                                                                                                                                                                                                                                                                              |
|--------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Construct validity | <ul style="list-style-type: none"> <li>• Use of multiple sources of observation</li> <li>• Rich case descriptions organized along research lines</li> <li>• Review of findings by the case companies</li> </ul>                                                                                                                      |
| Internal validity  | <ul style="list-style-type: none"> <li>• Use of strict / elaborate research protocol</li> <li>• Use of four researchers and “devil’s advocate”</li> <li>• Rich case descriptions organized along research lines and supplemented with explanation-building</li> <li>• Extensive cross-case analysis with pattern-matching</li> </ul> |
| External validity  | <ul style="list-style-type: none"> <li>• Broad research focus</li> <li>• Choice of case studies</li> <li>• Use of same protocol for all case studies</li> </ul>                                                                                                                                                                      |
| Reliability        | <ul style="list-style-type: none"> <li>• Use of strict / elaborate research protocol</li> </ul>                                                                                                                                                                                                                                      |

Table 4.1 Research design quality tests

### 4.3 Calculation of point values for perceived urgency – perceived feasibility diagrams

One specific methodological problem was the calculation of the pair values associated with perceived urgency and perceived feasibility, which, according to the research model, defined the character of the design outcome.

First of all, while the observations clearly identified individual factors, they were not associated with exact measurements of factor intensity. Therefore, the point values in the diagrams were calculated on the basis of relatively rough, rather than exact, estimates. The estimates were constructed as follows: each factor identified in Tables 4.2 and 4.3 was, based on the interviews and the researcher’s estimate<sup>119</sup>, assigned a weight of between -3 to +4 (-3 corresponding to a strong negative influence on perceived urgency or feasibility; +4

<sup>119</sup> The estimate was determined in a fairly simple, straightforward manner: on the one hand, during the interviews managers were asked not only to list factors influencing their decisions, but also to rank them. Also, the detailed descriptions of the decision-making process indirectly implied which factors were seen as particularly important. Since the researchers noted that factors, *when present (!)*, tended to be ranked similarly by all the companies, value was assigned in accordance to the estimated level of importance.



corresponding to strong positive influence). Weights for contributing factors identified as present in the change cycles were assigned for that cycle. Where a factor was only partially identified, the associated weight was decreased appropriately. Results varied from -7 to +12.5 for perceived urgency, and from -8 to +6.5 for perceived feasibility. Negative and positive values were grouped into zones (Table 4.4), which were then placed along the axes in the diagram (e.g. values of perceived urgency from -7 to -5.5 were placed in the bottom zone of the diagram, values from -5.4 to -4 were placed in the next, etc.) An example of the calculation is presented in Table 4.4, and a diagram is seen in Fig. 4.1.

| Group of factors                                       | Individual factor                                                                                                                     | Weight |
|--------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|--------|
| Issues related to institutional pressures              | 1. “Must look good” leads to denial and decreased perceived urgency of change                                                         | -1     |
|                                                        | 2. Pressures to keep employment up lead to decreased perceived urgency of change                                                      | -2     |
|                                                        | 3. Pluralism of interests leads to decreased perceived urgency of change                                                              | -0.5   |
|                                                        | 4. Old ways of doing business are seen as effective, thus decreasing perceived urgency of change                                      | -2     |
|                                                        | 5. Old ways of doing business are seen as ineffective, thus increasing perceived urgency of change                                    | +2     |
|                                                        | 6. Readiness to mimic successful restructuring practices increases perceived urgency of change                                        | +1     |
|                                                        | 7. Privatization leads to decreased perceived urgency of change                                                                       | -1     |
|                                                        | 8. Owners are happy with status quo, decreased perceived urgency of change                                                            | -2     |
|                                                        | 9. Owners are not happy with status quo (including takeover threat), increased perceived urgency of change                            | +2     |
| Financial issues including transparency of performance | 10. Lack of performance clarity and lack of indication of future financial difficulties decreased perceived urgency of change         | -1.5   |
|                                                        | 11. Performance clarity and indication of future financial difficulties increased perceived urgency of change                         | +2.5   |
|                                                        | 12. Financial crisis created high perceived urgency of change                                                                         | +4     |
|                                                        | 13. Financial underperformance detected by top management increased perceived urgency of change                                       | +2     |
|                                                        | 14. Financial slack decreased perceived urgency of change                                                                             | -1     |
| Issues related to opportunities and growth             | 15. Opportunistic behavior decreases focus and perceived urgency of change                                                            | -0.5   |
|                                                        | 16. Opportunistic acquisitions, alliances or strategic partners are used as “silver bullets” and decrease perceived urgency of change | -1     |
|                                                        | 17. Growth is seen as a matter of survival, which increases perceived urgency of change                                               | +2     |
|                                                        | 18. Growth is seen as requiring substantial changes and appropriate time, which increases perceived urgency of change                 | +2     |

| Group of factors             | Individual factor                                                                          | Weight |
|------------------------------|--------------------------------------------------------------------------------------------|--------|
| Issues related to leadership | 19. Top team wants stability or avoids change, thus decreasing perceived urgency of change | -1.5   |
|                              | 20. Change at the top increased perceived urgency of change                                | +1.5   |
|                              | 21. Ineffective leadership in previous period increased perceived urgency of change        | +1     |
|                              | 22. Top team wants to prove itself, thus increasing perceived urgency of change            | +1     |

Table 4.2 Factors influencing the assessment of change urgency and associated weights

| Group of factors                                      | Individual factor                                                                                                                                         | Weight |
|-------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| Issues related to institutional pressures             | 23. Estimate of not being able to handle stakeholders in expected delicate situation decreased perceived feasibility of change                            | -2     |
|                                                       | 24. Estimate of being able to handle stakeholders in expected delicate situation increased perceived feasibility of change                                | +1     |
| Issues related to industry and market dynamics        | 25. Estimate of industry and market dynamics as not favorable decreased perceived feasibility of change                                                   | -2     |
|                                                       | 26. Estimate of industry and market dynamics as favorable increased perceived feasibility of change                                                       | +1     |
| Issues related to resources (competence) availability | 27. Estimate of insufficient financial resources decreased perceived feasibility of change                                                                | -3     |
|                                                       | 28. Estimate of sufficient financial resources increased perceived feasibility of change                                                                  | +1     |
|                                                       | 29. Estimate of poor current level of competitiveness and competences as well as no differentiating resources decreased perceived feasibility of change   | -3     |
|                                                       | 30. Estimate of having some competence and differentiating resources increased perceived feasibility of change                                            | +1.5   |
|                                                       | 31. Estimate that the needed competence and complementary resources could be obtained through strategic partner increased perceived feasibility of change | +1     |
| Issues related to leadership                          | 32. Estimate of cooperative employees increased perceived feasibility of change                                                                           | +1     |
|                                                       | 33. Estimate of non-cooperative employees decreased perceived feasibility of change                                                                       | -2     |
|                                                       | 34. Estimate of strong and trusted leadership increased perceived feasibility of change                                                                   | +2     |

Table 4.3 Factors influencing the assessment of change feasibility and associated weights

| Urgency      |      | Feasibility  |      |
|--------------|------|--------------|------|
| Value        | Zone | Value        | Zone |
| > 8.5        | +4   | > 5.5        | +4   |
| 6 to 8.5     | +3   | 3.6 to 5.5   | +3   |
| 3 to 5.9     | +2   | 1.6 to 3.5   | +2   |
| 0 to 2.9     | +1   | 0 to 1.5     | +1   |
| -1.9 to -0.1 | -1   | -1.9 to -0.1 | -1   |
| -3.9 to -2.0 | -2   | -3.9 to -2.0 | -2   |
| -5.5 to -4.0 | -3   | -6.0 to -4.0 | -3   |
| < -5.5       | -4   | < -6.0       | -4   |

Table 4.4 Translation of point values into diagram zones

| Cycle | Urgency factors     | Weights        | Total urgency / zone | Feasibility factors | Weights      | Total feasibility / zone |
|-------|---------------------|----------------|----------------------|---------------------|--------------|--------------------------|
| 4.1   | 1, 11, 13, 14       | -1+2.5+2-1     | +2.5 / +1            | 25, 27 (part.), 34  | -2-1+2       | -1 / -1                  |
| 4.2   | 5, 7, 18            | +2-1+2         | +3 / +2              | 26, 28, 30, 34      | +1+1+1.5+2   | +5.5 / 3                 |
| 4.3   | 3, 4, 19, 20(part.) | -0.5-2-1.5+0.5 | -3.5 / -2            | 23, 25, 28, 29      | -2-2+1-3     | -6 / -3                  |
| 4.4   | 5, 17, 20, 21       | +2+2+1.5+1     | +6.5 / +3            | 24, 26, 28, 30, 34  | +1+1+1+1.5+2 | +6.5 / +4                |

Table 4.5 Example of calculation for Lek change cycles

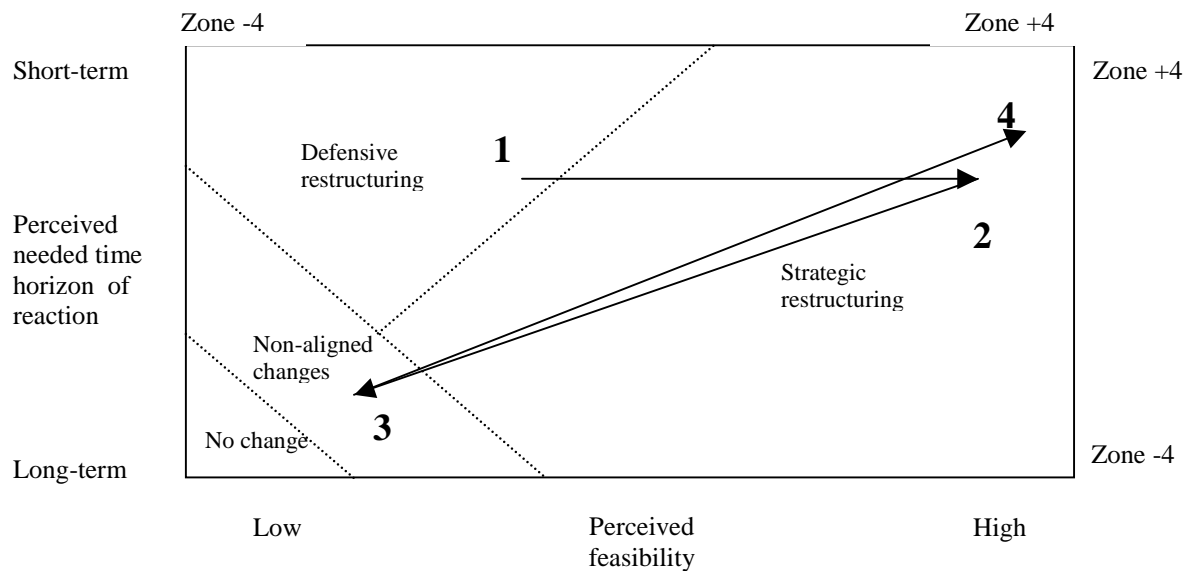


Figure 4.1 Diagram with design outcomes for Lek

## **5. Strategic Change Management: the cases of seven Croatian and Slovenian companies**

This chapter presents seven Croatian and Slovenian company cases. All (with the exception of Lura, which was formed in 1991) begin with a brief history of the company prior to 1991. This is followed by a presentation of company developments in the period from 1991 to 2003, organized under headings which indicate in chronological order the change cycles observed. Each case concludes with a discussion of the research findings, organized around the elements of the research model. Since a detailed cross-case analysis is performed in Chapter 6, the discussion of research findings in this chapter focuses on identifying the concrete manifestations of phenomena predicted by the research model.

### **5.1 Gorenje**

Gorenje is one of Slovenia's largest companies, with 520 million € of sales and 6,700 employees in 2002. Its main line of business is major household appliances (refrigerators, washing machines and cooking ranges). At the end of 2002 Gorenje ranked as number eight among producers of household appliances in Europe.

#### **5.1.1 Brief overview of company history prior to 1991**

Gorenje was established in 1950, when a group of craftsmen decided to start a workshop producing agricultural equipment. Like all companies in former Yugoslavia at that time, Gorenje was not private but was collectively-owned and governed by its employees. The company enjoyed early success and rapid growth. Within the first decade of its existence it began producing solid-fuel cookers and then moved production to a new factory in the nearby industrial town of Velenje, famous for its coal mining tradition.

In the early 1960s production was expanded to include washing machines and refrigerators, and the first appliances were exported to Germany as early as 1961. Under ambitious leadership and with strong local political support, Gorenje continued its fast expansion under the motto 'Everything for the Home'. Diverse business areas such as small household appliances, kitchen furniture, ceramic tiles, medical equipment, consumer electronics and telecommunications were gradually added to the portfolio and in the 1970s the company had 20,000 employees.

The company was well-positioned to reap the benefits of the political and economic situation in former Yugoslavia. Its domestic markets were practically closed to foreign competition, allowing the company to achieve more than comfortable margins. Slovenian products had a high reputation in other parts of Yugoslavia, and the company had no problems extending its strong brand name to several different product lines. At the same time, it was easy and relatively inexpensive to develop its own distribution and service network in all major cities throughout the country, thereby maximizing the potential of the broad product range.

While developing its highly diversified portfolio for the local market, Gorenje used the extra profits it then generated, as well as state-subsidized loans, to continue its early orientation towards exports. Significant investment in the distribution network and brand support in Western Europe began to produce results in the 1970s, when exports rose to one-third of total revenues and the steep rise in production levels also generated the first effects of economies

of scale. This trend was also supported by some clever bartering arrangements with the Soviet Union, where Gorenje's cheapest cookers became the product of choice for state building companies furnishing new houses in Siberia.

In 1978 Gorenje decided to buy Körting, a failing Bavarian consumer electronics company. While the decision was based on the argument of the increasing importance of electronic components in household appliances, it in fact led to Gorenje's brief excursion into entertainment electronics. A lack of international management experience, the inability to quickly adapt Körting to Gorenje's own strategic requirements in household appliances, and a reluctance to recognize the need for significant restructuring of Körting's poorly qualified workforce resulted in piling up of losses and Körting's ultimate sale in 1983.

This failed acquisition drained the company's financial resources and forced Gorenje's charismatic General Manager Ivan Atelšek, who had led the company for 28 years, to resign. On the more positive side, the crisis prompted a re-examination of the company's geographical expansion and diversification strategy. With the help of a major international consulting company, Gorenje succeeded in cutting its costs considerably while improving its product and service performance. In 1984 alone, the company managed to improve productivity by 30%, and towards the end of the decade it expanded the share of its export business to 50%. Yet, due to constant deficits in the Yugoslav trade balance and the high price of hard currency on the grey financial markets, even the losses made from exports could easily be compensated for by the high domestic margins and profits on sales for hard currency, thereby reducing pressure towards further productivity improvement.

The new General Manager of Gorenje, Herman Rigelnik, did not significantly change the strategy set by Atelšek. He continued to depend on a balance between sales of major household appliances in West European markets primarily based on a low-cost position, and on sales of a wide assortment of Gorenje goods in the domestic market of former Yugoslavia and in East European markets.

In the late 1980s Gorenje was approached by General Electric, and its management considered the possibility of selling the company to GE. Initial negotiations led to a due diligence process, which GE completed just before the collapse of former Yugoslavia in 1991. Anticipating the new market situation, GE offered an extremely low price for the company, which led the Gorenje management (in agreement with the Slovenian government) to break off negotiations.

Political tensions within former Yugoslavia mounted towards the end of the 1980s, when it became obvious to Gorenje's management that the federal state's disintegration was imminent. Before the war erupted, Gorenje changed the status of its offices in the capitals of other republics of former Yugoslavia to that of wholly-owned subsidiaries. It also put a lid on stock limits to avoid confiscation of large amounts of stock, and pushed for advance payments to avoid problems in collecting receivables.

Asked which legacies from its first forty years of development had the most important influence on the way Gorenje changed in the 1990s, the management indicated the following six:

- A strong position in the domestic market, together with the strong support the company enjoyed within Slovenian political arena;

- Various (on average positive) experiences with diversification, as well as a fairly broad conglomerate of product lines in 1990;
- A strong international presence with a well-established distribution network in Western Europe;
- The company's negotiations with GE, which allowed the company to learn about industry best practices;
- Excellent labor relations, firm loyalty of employees and strong ties with the local community;
- The long tenures of two strong leaders (Atelšek and Rigelnik).

### 5.1.2 Changes in the period from 1991 to 1994

Apart from changes in organizational and trading policies in “risky” parts of former Yugoslavia and the appointment of several new young managers, Gorenje made no visible changes on either the strategic or tactical level in anticipation of coming changes in the environment. According to the company records there were several reasons for this. On the one hand, the company did not prepare precise financial simulations of future scenarios. A significant part of the management simply refused to believe that the changes would have a dramatic impact on Gorenje, and had never engaged in systematic thinking about the future. The period prior to 1991 had been plagued by huge accounting problems due to non-transparent accounting practices and intervals of high inflation. Thus it was difficult to estimate the effects of different changes on the overall Group position and on the position of individual companies, this in turn rendering it hard for the management to estimate the scope of the potential financial crisis. In the absence of a hard financial argument, the management was reluctant to start downsizing because of the dire political consequences this would have for relationships with the national political elite, the local community and the labor force, and for the image of top managers and the company. Given the mature nature of the industry, no other strategy apart from downsizing was considered in the search for necessary short term results.

The crisis hit hard in 1991, when Gorenje lost 40% of its (most profitable) revenues due to the collapse of Yugoslavia. The remaining Slovenian market accounted for just 5% of the production of household appliances. The core business was bleeding under the pressure of a poor cost position and a significant drop in volume, but at least it was generating some revenue. The majority of exports were going to Western Europe, where product positioning was poor, but demand was stable. Most other businesses within the Group were practically bankrupt, and there was little hope that they could survive the loss of the Yugoslav markets, since the products they were carrying were seen as uncompetitive in Western Europe, or as requiring different distribution channels from those of Gorenje.

As the result of the crisis, the Gorenje Group followed a strategy previously implemented by another leading Slovenian company, the Iskra Group (electronics industry). The latter's management had found legally-acceptable ways to cut the ties among the companies belonging to the Group, and in practical terms dissolved it, leaving individual companies to find their way out of the problems but ensuring that one major failure would not sink all the companies within the Group. Gorenje GA, the household appliance division of Gorenje, was a strong proponent of such a solution. Jože Stanič, who became the General Manager of Gorenje GA in the early days of crisis, believed that becoming independent was the only way to secure the necessary discipline, flexibility and speed of reaction. Seeing his company

totally cash-starved, he could not afford to waste money on non-related businesses that were in an even worse position. He was supported by colleagues from a number of smaller divisions, some of whom expected to benefit from the coming privatization of their companies. Without other viable solutions, Rigelnik bowed to pressure and left Gorenje, opening the way for the changes.

The first reactions of Gorenje GA focused on retaining the liquidity necessary for normal operations. The company entered negotiations with its suppliers, trying to maintain its cost position while improving payment conditions. It also put pressure on the distribution network to increase volumes and margins in Western markets. However, it became evident that the volume goal was easier to reach than the margin goal, for which the company lacked up-to-date products. At the same time, poor operational results made it impossible to finance the R&D efforts and production modernization required to produce new products. Stanič and his team resolved the impasse with two simultaneous actions.

First, they secured employee support for an austerity program. Given full information about the situation the company was in and the need for employee support to secure its survival, the employees agreed to significant pay concessions which in practice brought wages below the minimum level accepted in national union negotiations. In return, the employees received certificates guaranteeing them a certain percentage of stock after the company was privatized. Although the risk for the employees was substantial, since in the event of bankruptcy they would be left with no valid claims towards the company, they unanimously accepted the deal. This significantly reduced costs and allowed the company to meet its financial obligations more easily. It also allowed the management to avoid a drastic reduction in the headcount, thus scoring important points with the political establishment and the local community. With that concession in his pocket Stanič turned to the banks, which were fully under government control. Despite considerable weaknesses of financial performance which would in normal circumstances have made Gorenje GA's request unacceptable, by using his political influence Stanič secured a major financing package from the largest Slovenian bank, allowing the company to secure liquidity and go for rapid product modernization.

The company's main objective in the whole period from 1991 to 1994 was to consolidate and restore profitability, Stanič and his team pointed out several resources which were critical to that process. As mentioned previously, one was the financial "infusion", which allowed the company to restore liquidity and normal cost structures, as well as providing the starting funds for a new cycle of product development and production improvements (after arranging the financial package the company was almost solely dependant on internal financing). In this context, one of the first investments the company made in the early 1990s was in a financial and management accounting and control infrastructure, which allowed the management not only to better plan and supervise cash flow but also to make more accurate judgments concerning the product portfolio and necessary cost improvements.

Despite the fact that all the principle decisions made in the consolidation period came from the top, the top management was ready to recognize the importance of the soft side of the company and devoted a significant portion of their efforts to strengthening it. All internal and external sources termed the loyalty of Gorenje's employees, their trust in Stanič and his team, and their commitment to the company as "fanatic". Up to 1994 Gorenje's management did not clearly communicate to the employees its developmental vision, but reinforced employee loyalty through the ownership certificate program and the intense communication associated with it. Trust was clearly reinforced by the mere fact that the company avoided lay-offs

despite the obvious problems it had. The management used every opportunity to send dual messages to the employees, one lauding recent achievements confirming company viability, another warning of the continuing threat.

As a result of trust, but also as a result of the extremely limited job opportunities within the region, Gorenje managed to retain practically all of its technical talent during the first change cycle. Although overall technological competence was not at the level of the best in the industry, it allowed the company to significantly improve product quality while at the same time decreasing costs. Stanič made it clear that he would not tolerate sloppiness and low quality, and personally became the champion of quality-related activities in the company.

The top management identified virtually no external barriers (apart from the standard highly-competitive environment which characterizes the household appliances industry) and only a few internal barriers to implementation of the consolidation strategy. Barriers were to some degree found in the scarcity of financial resources, but even more so in inherited internal inefficiencies, lack of some skills (in both production and sales and marketing), and in inappropriate attitudes (especially in quality and production discipline, and in initiative-taking at the middle management level).

#### 5.1.3 Changes in the period from 1994 to 1996

At the beginning of 1994 the company's financial crisis became significantly less acute. Not only had operational liquidity been more or less restored through austerity measures and significant pressure on the sales network in Western Europe, but the company had secured a financial package allowing it to consider its first major investments since 1991. The management also had before them clearer indications based on data from the new management accounting system, which pointed out that further cost improvements were needed, as well as price increases, since margins were still very low.

Since the company had managed throughout the crisis to retain all of its technical talent, once the financial resources were available it proceeded swiftly with the necessary technical and technological activities. As a result, in 1995 Gorenje GA introduced its Freon-free refrigerators at a price considerably above that of the previous product line. In parallel, the company also implemented a major re-engineering project with one of the leading global consulting companies, further reducing costs.

The major strategic project completed by the management in this period was the privatization of Gorenje GA. According to Slovenian privatization law employees could use their privatization vouchers as well as their wage compensation certificates to buy stock. However, due to the company's size it was clear that this would amount to only a small percentage of the overall company value, which had been determined in negotiations between the company and the state Privatization Agency. The management avoided controversy, and readily agreed to the high initial book value of the company proposed by the Privatization Agency (most experts shared the view of the management that this initial value was overstated by at least 30%). They also accepted two state-owned funds as the most important owners, with the remainder of shares distributed among a large number of shareholders. When privatization was concluded Gorenje GA changed its name to Gorenje.

Later developments confirmed that most of the small shareholders were ready to place their full trust in Stanič and his team: in all shareholder assemblies proxies controlled by the



management were the second voting block, almost equal in size to that of the government representatives. This shareholder structure has not changed significantly since privatization.

Gorenje's experience in West European markets and in particular its distribution network were seen as vital. Without significant investment in brand support it was able to increase volumes above industry growth rates throughout the period of consolidation and, seen as equally important, maintain an overall 70:30 ratio between its own brands and private labels.

Gorenje's technological competence was further developed, allowing the firm to keep improving production processes and product quality while decreasing unit costs, as well as generating a continuous stream of product alterations and new product developments. To facilitate these developments Gorenje encouraged its employees to participate in external professional activities; engaged in external benchmarking; and used top-class consultants to pinpoint opportunities for improvement and strengthen the ability to utilize them. Consultants focused in particular on process analysis, benchmarked cost structure, productivity and process flow with world-class competitors. All of this obviously required high-quality technical talent, but also high overall workforce quality and the appropriate company culture.

In 1994 the management began to extend the scope and focus of communication from general statements about the future which the austerity measures would secure, to concrete elements of the business strategy required along with cost-cutting.

After 1994 principle decisions were never formally announced before obtaining feedback from some 50 key managers. Stanič personally maintained an open door policy and engaged in numerous informal meetings with employees and members of the local community. The management was direct in discussing the challenges faced by the company, but at all times kept stressing the ability of Gorenje and its employees to meet them. Stanič also insisted on making as few promises to the employees as possible, but kept all of them on without exception. Since the management had identified job security as the main employee concern, they implemented an explicit policy of no non-voluntary terminations except for major disciplinary offences. Also, the company managed to maintain paycheck regularity even during the times of the worst liquidity problems.

However, Stanič balanced this soft approach with an emphasis on rigorous work discipline, adherence to quality standards, relentless cost-cutting and performance in accordance with set goals. He was quick to replace poor performers among Gorenje's middle managers, while at the same time insisting on clarity in promotion and demotion criteria and a fairness in the process which he expected to be observed at all hierarchical levels. This led to some turmoil among the (especially older) managers, but never to an extent creating a negative atmosphere in the company.

Since due to austerity measures salaries were not attractive, Gorenje depended on other factors to keep their most important employees and attract new high-potential ones. The most important was its strong ties with the local community, where Gorenje was the model of a successful company even in the time of crisis. It was also among those rare companies offering true career growth opportunities and interesting jobs for technical experts.

Gorenje's management did not see many changes in the barriers to implementing their strategy. Although the situation was improving both in terms of financial resources and internal competence, it was still far from excellent. Fears concerning personal futures with the

company were again identified as a major obstacle, one more easily dealt with on the shop floor level than among middle managers.

#### 5.1.4 Changes in the period from 1997 to 2003

Towards the end of the second period the management identified several new factors which led them to somewhat revise their strategy. The first was the growing potential of the Central and East European markets, as well as growing international competition in these markets. Although Gorenje had started to penetrate those markets earlier, seeing them as the only ones in Europe with significant growth potential, it did not engage in systematic activities either to protect its inherited brand position in the countries of former Yugoslavia or to build sustainable positions in other countries in the region. Although some Gorenje managers believed that the company possessed huge advantages over competition in its long-term presence in the region, events proved that the situation in the region had changed, to the extent that new distribution networks would have to be built, new products introduced and clearly positioned against competition, and investment in intensive brand promotion was necessary. In Hungary, Gorenje followed an opportunistic strategy and managed to achieve a market share of more than 30% within 3 years, only to see that market share dwindle to a few percent over the next 3 years. This experience, among others, persuaded the management that more focused action was needed. However, the company was profitable again and had a free cash flow which could support the required investment. Thus, the management decided to redefine strategic sales territories and place more emphasis on the region.

The second area in which Gorenje's management saw the need to redefine the company's position was product portfolio strategy. Gorenje had traditionally depended on the fast follower strategy, which began to be implemented more consistently in the consolidation period. This strategy depended heavily on the flexibility facilitated by technological competence. It also created a few problems for the company's cost position, since it generated small series and an increasing number of SKUs. However, the management identified new trends in consumer behavior, which the company interpreted as a call for more differentiated and ecologically-sound products. Since it was estimated that Gorenje had too limited a potential for differentiation on the basis of true technological innovation, the company decided to differentiate on the basis of user-friendliness and design. These two concepts were incorporated into the systematic product line overhaul started in 1997 and forecast to last until 2005. A strategic partnership with Pininfarina design studio was forged in order to create a strong design brand. To utilize the potential of the new product lines, however, the company also started to gradually reorganize its distribution network and invest a significantly larger amount of money in various marketing activities, including training of employees and distributors. It also invested in the upgrading of production capacities.

While throughout consolidation the company focused completely on major household appliances, with increased investment capability Gorenje returned to a diversification strategy. Its management again cited its strong brand position in several countries as an opportunity; it also saw the need to improve its relatively poor returns from the core business by engaging in higher-margin areas such as kitchen furniture. A few companies from the former Gorenje Group were bought back, as well as a failed Slovenian furniture manufacturer. Gorenje also engaged some parts of its domestic and foreign network in trading activities.

In 1996 the employees reopened discussion of the level of salaries. While the company was able to prevent strikes, some good will was lost and labor costs increased somewhat. Gorenje also started to invest more in employee education (e.g. every employee on average receiving

2.5 days of training, with middle management being the core target of educational efforts), introduced more teamwork and management by objectives, and significantly decentralized decision-making. The company also intensified its internal competition and selection processes and further rejuvenated middle management.

As an example of the benefits from its trust in young talent Gorenje's management often cited the experience of one of the worst disasters to hit the company in the 1990s. The galvanization plant, which produced protective coatings for all metal sheets used in the production of appliances, was totally destroyed in a fire. In order to avoid complete production stoppage, Gorenje had almost immediately to revert to outsourcing. Not only was this significantly more expensive than its own production, but it also created enormous logistical problems, and it was very difficult to secure the necessary volumes over a longer time period. Thus the company immediately launched the rebuilding of the plant. The initial estimates of both internal and external experts indicated that close to two years would be required for this, Gorenje's performance seriously jeopardized in the meantime. A team of three young engineers was given the task of leading the project, which some industry observers questioned as an almost hazardous move. However, they managed to bring production into line in less than six months, and two of them were immediately promoted.

Stanič continued to play the role of figurehead. His attention was divided among several areas. He kept shareholders (in particular the state-related majority) at bay, thus lowering pressure for dividend payouts and allowing the company a policy of high investment and below-average returns in order to improve its strategic position. He also kept up intensive personal communication with a wide circle of employees, further strengthening his popularity. At the same time, he continued to push for higher performance and better quality, directly engaging in personnel decisions at the middle management level.

The critical resources needed in this period, as identified by the top management, were similar to those of the second period. Gorenje still depended on its market competence (including its distribution network) in Western Europe, a level of technological competence which allowed flexibility, and a committed workforce. It made use of its brand position in countries of former Yugoslavia (i. e., redeployed an existing resource), and stretched its technological competence further in the area of new product development, augmenting it with design competence. New resources included market competence (and an improved distribution network) in Central and Eastern Europe, as well as committed and well-educated middle managers ready to take initiative.

On the other hand, main internal barriers were identified in employees' rising frustration with poor compensation, especially among those who were above shop floor level, but lacked clear career prospects. Also, as it relied almost exclusively on internal promotion, Gorenje began to suffer a lack of top-quality people, especially in R&D and sales and marketing. Finally, an increasing number of managers felt that too strong a focus on the local environment was having negative effects on the company culture.

#### 5.1.5 Changes in 2003

From 2001 onwards the top management faced two imminent challenges: Stanič had to decide whether to go for a third term as President of the Management Board or to retire in 2003; and the company had to prepare for the changes presented by Slovenia's accession to the EU in May 2004. Stanič decided to retire, and proposed that the Supervisory Board nominate Franjo Bobinac, Management Board member in charge of sales and marketing, as his successor.

Bobinac brought three new members to the Management Board, two of whom were in their thirties and came from outside Gorenje, thus clearly departing from the tradition of internal promotions and the seniority required for top positions.

In his first public statement after his appointment Bobinac declared three strategic priorities for the company, to be reached by 2006: to become number five in the household appliance industry in Europe; to reach consolidated sales of over 1 billion €; and to nearly double the ROA. When questioned about the key challenges, he indicated the need to move part of production to a non-EU country to compensate for new tariff barriers when Slovenia joined the EU; to consolidate brand positions throughout strategic market territories; to protect the company from a possible hostile takeover and become more active in growth through acquisitions; and to significantly internationalize the company and its culture while maintaining both an openness for dialogue and its employee commitment.

Obviously, his goals and stated priorities significantly surpassed expectations, and went beyond the changes predicted to follow Slovenia's accession to EU. Although not explicitly, they admitted to some shortcomings in the previous change phase, in particular indicating the need for improved clarity of strategic focus, both in terms of the company's target positioning and its means of achieving differentiation. From Gorenje's sales and marketing side, Bobinac had a thorough understanding of the market situation and industry dynamics. He was convinced that Gorenje was capable of covering a wide price range, from lower middle to high (but not top). The company had already announced its interest in the North American market and its first private label deal in US, and was obviously trying to expand beyond Europe. Bobinac believed that due to industry dynamics Gorenje needed to achieve high growth in order to remain viable, which would require many different activities and could show results only over a period of several years. He estimated that the diversification strategy had limited potential, but was ready to implement all of it, while securing the rest of the growth through the core business. He felt that some of the company's owners would most likely exhibit less patience in the future if returns remained low, and that employees, given the changes in the value system of the younger generation, would require new motivations and a different reward system. Last but not least, he indicated clearly his ambition to be remembered as the fourth in the line of outstanding Gorenje leaders. Discussing (expected) barriers, most managers identified the lack of high-potential people, an inert culture, and complacency (i.e. lack of true motivation for change) as the most critical internal barriers.

#### 5.1.6 Summary of research findings from the Gorenje case

Four change cycles were identified in the period between 1991 and 2003. In the first cycle change began late, when the financial situation (and in particular the liquidity) of the company became critical. The major factors influencing this late start were institutional pressures (to maintain employment, and to retain the positive image of the company and its top management); lack of transparency of the consequences of external change for company performance; and lack of consensus among top managers. The role of financial slack can be seen as negative, since the change was started only after slack had been used up. It is interesting to note that the true agents of change were from divisional management, rather than the Group level, which can to large extent be explained by the relatively low level of synergy within the Group, as well as a heritage from the social ownership system in which the Group had no effective ownership control over divisions.

Once the change was initiated, it took on the clear characteristics of defensive restructuring. The chosen strategy was heavily influenced by institutional pressures (and, in particular,

mimicked another company seen as a role model by the institutional environment). The fact that the management of the Group's core business opted to dissolve the Group can easily be interpreted as indirect downsizing, since it caused layoffs in other divisions. Downsizing was also carried out in the core division, although strictly via voluntary terminations, including retirements. The new organizational template included a significant amount of centralization in the first period of change, a focus on cost reduction, and a focus on existing core markets (although in the case of Gorenje these, for obvious reasons, were not local). There was no evidence of major organizational learning, although there was a clear emphasis on quality improvement based on stricter discipline. Critical resources for the success of the strategy in this phase were financial infusion, a new accounting and control system, market competence (including the distribution network) in Western Europe, and a committed workforce which trusted its leaders. Leadership interventions were limited to top-down decision-making and intensive communication with employees and other principal stakeholders (the local community, the political elite in Slovenia, banks, customers and suppliers). A certain amount of coercion was noticeable, in particular in the use of fear of job loss as a tool to discipline the workforce and to lower salaries, but this was balanced with promises of no workforce reductions and with ownership certificates.

The barriers identified only partially confirm the theoretical predictions. Strategic uncertainty (although the cause for the late trigger) was not identified as a barrier. Poor skills and inappropriate attitudes were identified in accordance with predictions. Fear did not act as a barrier universally, but did create more problems at the middle management level. The explanation for this lies in the fact that while use of coercion, management of expectations and trust worked when applied to production workers, for middle management insecurity was intensified by fear of lacking the needed skills (which was not the case with production workers), and by a real lack of experience and competence in the context of new roles and behaviors (e.g. taking initiative).

It is also very interesting to note that in the case of Gorenje the second phase continued the emphasis on cost-cutting, but with a significant change in its nature: it was used as part of the competitive strategy rather than as a reaction to crisis, and was combined with other activities to improve added value. In this way the nature of restructuring changed from defensive to strategic. The transition from the first phase of purely defensive restructuring was facilitated by two factors. The new vision was actually a subset of the vision which existed prior to 1991, and it resurfaced when the management estimated that the company had the resources to pursue it. The critical resources for beginning strategic restructuring were financial resources and technological competence. The former was only to a small extent built over time: most financing was secured through leadership intervention as a result of institutional pressures. The latter, which normally requires significant efforts, already existed in the company and was not lost during defensive restructuring.

Another obvious deviation from the first phase was more reliance on bottom-up processes and clear efforts to launch new processes in the company which would facilitate learning. This included the use of foreign consultants and a focus on technical education.

The trigger for the third cycle of changes was the top management's interpretation of the new opportunities in Central and Eastern Europe and of competitive dynamics in the industry, as well as their reinterpretation of consumer needs and wants in all markets. Again, the trigger was reinforced by the estimate that the resources needed to implement the change were sufficient. The new organizational template confirms all the predictions of theory: depending

on the specific industry, the company decided to combine low cost and higher added value positions; it reorganized along main product lines and placed clear emphasis on R&D, production and distribution (with somewhat lower-than-expected emphasis on marketing, to be corrected in the last cycle of changes); and it turned towards global benchmarking and external partnerships for improving critical elements of the value chain. Gorenje continued to depend on all the critical resources identified in defensive restructuring, with intensified use of technological competence and customer intimacy for new product development. With his strong institutional connections, Stanič managed to achieve an ownership structure which reduced pressure on immediate financial performance and gave the company enough time and financial resources to invest in the new strategy.

According to expectations the company started to come up against barriers related to the growing pluralism of interests (both at the middle management and production worker level), but was capable of neutralizing them, primarily through higher levels of decentralization, more grass-root change management and continued intensive communication. The pressure on middle management performance is a leadership intervention not predicted by the research model.

While the organizational template resulting from the fourth cycle of change has not yet fully emerged, it is clear that what triggered this cycle was the interpretation that changes in the context (in particular, EU accession combined with industry dynamics) were significant enough to require action. It is also likely that the decision was heavily influenced by a predicted increase in institutional pressures (especially owners' demands for higher returns and their readiness to accept hostile takeover). Although initial signals indicate that the new organizational template departs significantly from the old one, it remains to be seen if and how this will be achieved.

## **5.2 Kolinska**

Kolinska is a medium-size food company from Slovenia, with 100 million € revenues and 600 employees in 2002. In the last decade it has consistently ranked among the five financially top-performing food companies in Slovenia.

### **5.2.1 Brief overview of company history prior to 1991**

Kolinska is a company with almost 100 years of tradition. It was started as a small workshop producing a coffee substitute. After World War II it was nationalized and enjoyed slow growth until the late 1980s. Following the business practices of many medium-size companies in former Yugoslavia, it had built up quite solid manufacturing and distribution capabilities. However, the company did not focus on developing its own product portfolio, but instead established licensing relationships with two major food companies, Nestlé and CPC International (later renamed Bestfoods, which in 2000 merged with Unilever). Through its relationships Kolinska had access to a limited number of product lines (such as soups, mayonnaise and various spices and dressings), which accounted for the majority of its sales in the 1980s. The company was successful in covering the whole territory of former Yugoslavia with its distribution network and had particularly strong sales in the eastern part of the country. Sales in Belgrade (the capital of former Yugoslavia), for example, were bigger than those in the whole of Slovenia. Along with its licensed products Kolinska had a few products of its own, typically in lower value added segments. The notable exception was baby food, which had not only achieved solid success in the domestic market but was also well-known in the former Soviet Union.

Kolinska's top management team in the late 1980s consisted of highly experienced members: next to Lojze Deželak, general manager, three team members covered the key functional areas of finance, manufacturing and commercial activities. Although the company prided itself on a strong market orientation, looking back most of its managers underline the focus on production, which was highly flexible due to its semi-automated nature, allowing for small batches. Despite being in the fast-moving consumer goods industry the company gave little attention to marketing and brand-related issues, since the high demand – low supply pattern of the former Yugoslav market did not require much investment there.

As early as in 1989 Kolinska's top management became concerned about political and economic developments in former Yugoslavia. They prepared several scenarios based on the assumption of different levels of market collapse. All of these focused on the financial implications of the future market situation. They did not consider possible substitution of markets as the solution to the revenue decrease in domestic markets, since the management was convinced that Kolinska could not effectively compete in western markets and estimated that the fast-moving consumer goods markets in Central and Eastern Europe would not offer the needed potential in the short term. The justification for this belief was simple and not lacking in arguments: the company had no established brand in the west and had too few resources to build a major brand from scratch in any sizable national market in the EU; tariff barriers would make its products costly; its own product portfolio was limited and did not include products which could be easily differentiated; the company had little know-how in marketing area and only limited knowledge of western markets; etc. On the other hand, CEE countries were clearly heading into transition and it was safe to believe that fast-moving consumer goods markets would suffer from a drop in living standards and the collapse of distribution systems. That was why Kolinska was getting ready for downsizing.

### 5.2.2 Changes in the period from 1991 to 1993

The first practical change as a reaction to crisis was to reorganize the sales offices in other republics of former Yugoslavia and convert them into fully-owned subsidiaries. In doing that, Kolinska joined many other Slovenian companies, since it was believed to be the most practical solution to the possible problem of losing control over assets in those republics. Loss of control was seen as likely due to the uncertain future of socially-owned companies, as well as various legal possibilities allowing parts of socially-owned companies to declare independence from their mother companies.

The actual events of 1991 and 1992 matched the most pessimistic scenarios. Kolinska lost sales in Serbia completely, but it also lost a significant amount in Croatia and Bosnia, which were rapidly sliding into armed conflict. The collapse of the former Soviet Union added to the problems. Overall, Kolinska lost almost 70% of its sales.

The first round of downsizing was based on the previously developed scenario. Deželak managed to keep an open dialogue with the labor unions and convince them of the necessity of cuts, promising that the company would implement all the possibilities of soft downsizing. The management reasoned that a gradual approach to downsizing was the only realistic alternative, since an immediate reduction to the optimal number of employees would be too costly, create internal unrest and also create major technological problems. Thus, early retirements and voluntary terminations were used at first.

Although the financial situation was kept under control and the company operated with tolerable losses, it soon became clear that soft reductions would not be sufficient. The management prepared the “technological surpluses” program for workforce reduction, which in accordance with the law was possible if the company could prove a significant drop in demand and production levels. Although the company had to observe many rules in the process, the program created some space for the management to selectively downsize, targeting employees with poor performance or those unwilling to commit to expected changes in behavior. By the end of 1992 this brought the number of employees from 1,200 down to 850, an action seen by many as only the first round of necessary cuts.

Another measure taken during the first cycle of change was asset restructuring. Kolinska’s management examined the possibility of getting rid of non-performing assets, but despite clear objectives and a professionally sound approach realized that, due to low demand in real estate markets, the benefits would be negligible.

In order to maintain control over the situation, a more elaborate short-term planning and cost control system was introduced. Although it did not meet internationally-accepted accounting standards, it gave Kolinska’s management a solid insight into the company’s performance and allowed it to accurately plan cash flows, thus avoiding liquidity problems even during the period of lowest sales.

Although the management’s attention was primarily on cost control, some early attempts were made to boost sales outside of the domestic markets. Kolinska tried to penetrate Czech and Polish markets with some of its own products, but did not achieve good results. Lack of experience, limited product potential and the extremely limited managerial pool available to run such projects were seen as the key reasons for the failure. On the other hand, the company was successful in its negotiations with Nestlé, which led to a broadening of the product range for licensed production as well as distribution.

According to Kolinska’s top management, several elements were vital to the survival of the company and the successful completion of the first change cycle. First of all came the ability to downsize without engendering strikes or other major disturbances to the business process. Deželak could rely on a homogeneous senior management team with clearly-stated objectives and a high level of commitment to them. Next, while front-line employees were fairly passive, they seemed to accept the management arguments tolerably well, or at least accepted their suffering without too much grumbling. Flexibility of manufacturing also proved to be important, since market reality had forced batch sizes down. But the company managed it, and even though higher costs were incurred these were within an acceptable range. However, this also meant that the company focused primarily on small optimizations within the existing manufacturing system and did not try to take major steps ahead or alter the concept of semi-automated production. Finally, pressure on domestic sales and distribution improved efficiency and resulted in both increased sales levels and some cost savings.

Kolinska’s management identified several barriers to the implementation of downsizing and other cost-cutting measures. Institutional pressures, including paying the costs of downsizing as required by the law, as well as negative effects of downsizing on employee morale, were seen as a major factor in slowing down its implementation. As noted before, critical obstacles to those elements of change which tried to go beyond cost cutting were many. Although the company managed to avoid a severe liquidity crisis, it did not have significant spare resources to invest into major product portfolio extensions or brand position in a high-potential market.



Shop floor employees were not highly motivated and appeared to be loyal to the company primarily because of the lack of opportunities elsewhere. The middle management was particularly weak, both in terms of numbers and in true managerial capacity. This weakness extended to professional experts, especially in the areas of marketing and new product development, and slowed down the implementation of cost-cutting measures, particularly when it came to process improvements.

### 5.2.3 Changes in the period from 1993 to 2003

The first important project following radical downsizing was the company's privatization. Kolinska's management considered the option of using privatization as the first step towards selling the company to a strategic partner, but decided instead to remain independent. The main reason was their estimate that Kolinska was not an attractive proposition for a strategic partner, since it had a very limited local market, modest production capacities, and a relatively low level of brand equity. Instead, the company's management orchestrated the privatization process with an eye to a fairly dispersed ownership structure, employees to have 30% of shares, two parastatal funds being the next important owners and the rest going to a large number of private investment funds and farmers cooperatives (a legal requirement for all companies in the food processing industry). While lasting, the privatization process did not directly affect the company. When it was finished, the top management lobbied the new owners to obtain a mutually-acceptable Supervisory Board composition, in the process leaving significant power with the management.

This relationship in principle remained the same following privatization, the only important change being a significant reduction in the employee ownership share, which dropped from 30% to 4%. Kolinska's top management stated clearly that reaching its financial goals as set by the company's owners was a priority for the company, and always managed to deliver the results. It was also content with the dispersed ownership structure and did not encourage any major consolidation.

While privatization was a legal requirement, all other strategic changes were left to the discretion of the management, who regularly assessed the situation in the context of the annual planning process, but never returned to the practice of preparing long-term development scenarios such as that of 1989. These assessments did not alter the key strategic direction during this period. The management did not see any immediate danger to the company which required drastic responses, but was constantly aware of certain long-term pressures demanding continuous downsizing of the workforce and process improvements. The main driver here was the growing cost of labor, plus the industry's expectations of productivity improvement.

Kolinska's management also focused on the relationship with its two strategic partners, Nestlé and CPC International. What the company learned from the relationship, to which the management granted much importance, led to further improvements in its manufacturing process, including the introduction of the lean manufacturing approach and the further refinement of costing systems. Since it was obvious, however, that the growth potential from this cooperation was limited, the management discussed various other growth options. Although the possibility of obtaining organic growth through investment in Kolinska's own product lines was considered, the management estimated that this, too, had only limited potential. Defining Kolinska as a follower with a relatively wide product portfolio, they were reluctant to focus, fearing a negative impact on the spread of overhead costs and a possible significant short-term drop in profitability. The top management wished to avoid such a

development, sensing potential problems with owners satisfaction, and hoping to prevent owners interference in the company.

An example of the practical consequences of this approach can be seen in the company's chewing gum line. Prior to 1991 Kolinska had developed its own product, which was sold primarily in the local market. Although it was not seen as technologically advanced, it was well received and had gained a solid market share and brand recognition. After 1993 Wrigley approached the company with a proposal to buy the production plant for its regional purposes. Kolinska rejected the proposal, but failed to invest into the product, plant modernization or brand support. After several years of uneven battle with Wrigley and other western competitors Kolinska was forced to pull out of the chewing gum business.

In 1995 the company had to deal with a major external event with high disruptive potential. Licensing contracts with both Nestlé and CPC International were expiring, and the management had received indications from Nestlé that it was not willing to renew under the same conditions. During the negotiations Nestlé demanded a change of relationship in which Kolinska would remain a contractual manufacturing partner, but would sell all Nestlé products (those manufactured in Slovenia and those imported) through a joint venture company controlled by Nestlé. At the same time, both Nestlé and CPC International were increasingly concerned about the exclusivity of their relationships, seeing a potential conflict of interest within Kolinska were it to continue producing and distributing the products of both companies. In the end, Kolinska decided not to sign the contract with Nestlé, but to expand its cooperation with CPC International. A new four-year contract was again based on licensing, which allowed Kolinska to get from CPC International all the product lines which it had lost from Nestlé. The only Nestlé product kept for distribution was Nescafé, since Nestlé's new distributor had its own strong coffee business.

These negotiations with strategic partners left some cracks within senior management, since some felt that the company did not have consistent objectives and that due to poor tactical performance had not used all its opportunities well. Nevertheless, the company moved fast to deal with the new situation. It used its relationship with Slovenian retailers to push new products, and complemented this with strong advertising to create brand awareness. Although the impact on product categories where new CPC International replaced Nestlé products was negative, as the new products failed to reach the old level of market share, an excellent tactical reaction prevented major losses and allowed for growth due to some completely new licensed products and more focused work on distribution channels.

Under pressure from owners to secure growth above the rates achieved in the period to 1995, Kolinska's top management decided that the solution would be to acquire smaller or medium-size Slovenian food companies with reasonable product positions and market potential. Kolinska had had a positive experience in 1992, when it bought Talis (a small vinegar manufacturer facing bankruptcy), transferred production to its own facilities, closed the Talis plant and used its excellent domestic distribution network to push the product (a food commodity). However, the management was also aware of the limited possibilities of finding good acquisition targets, and decided to react to emerging opportunities rather than engage in a systematic search for and development of possible takeover situations.

One such opportunity came in 1996, when a local conglomerate consisting of spa tourism and mineral water businesses went bankrupt. Kolinska bought Rogaška Vrelci, the mineral water division, and thus added mineral water to its collection of business lines. It decided to re-

brand the product and extend the line with still mineral water in new packaging, but the results were disappointing. However, excellent results, far exceeding expectations, were achieved with an existing niche product, a mineral water targeted for health purposes. This product also had regional branding in countries of former Yugoslavia, enabling Kolinska to increase international sales through its regional network.

Other takeover opportunities emerging in the meantime were not exploited, based on negative assessments of the potential offered by the target company. For example, Kolinska decided not to diversify into the poultry business, although it could have bought the second-largest poultry company in Slovenia on very favorable conditions.

The Russian crisis adversely affected the company, especially its baby food business. However, despite a loss of about 1 million €, the management decided not to pull out of Russia since it estimated the crisis to be short-term, more than compensated for by the long-term potential of the market in which Kolinska claimed to have more than 20% of the market share.

In 1998 Kolinska also seriously considered a possible merger with another Slovenian food company of approximately the same size. The first analysis indicated several potential benefits. The main ones involved cost reduction and obtaining a wider, more coherent product portfolio. Also, the two companies would complement each others' strengths, since Kolinska was stronger in manufacturing and distribution, the other company in new product development and marketing. However, negotiations eventually broke down because of differences in the positions of the two management board presidents on post-merger share valuation and management structure. This created additional tension among Kolinska's senior management, some managers believing strongly that the company had lost an excellent opportunity for more radical change.

Following the expiry of the licensing contract with Bestfoods (formerly CPC International), Kolinska had in 1999 to negotiate a new one. Bestfoods announced this to be the last licensing contract it was ready to sign, and that within five years Kolinska would have to establish a "normal" relationship as a manufacturing outsourcer and distributor. Bestfoods established a marketing organization in Slovenia which took full charge of those activities, and hired a senior manager from Kolinska to lead it. A new business model significantly cut Kolinska's margins for the licensed products. As a result, Kolinska shifted its focus away from licensed products, whose share in overall revenues in the period from 1999 to 2002 fell from 40% to 22%.

The next successful acquisition came in 2000, when Kolinska bought several brands and related formulations, including Cockta, from a bankrupt Slovenian beverages company. Cockta was a specialty flavored cola with long tradition, and a surprisingly vital brand in the region. Using the experience from the mineral water business Kolinska moved fast to push the product through its distribution channels, and achieved superior results. This for the first time made the management more articulate about a strategic interest in beverages, which resulted in another acquisition, a mineral water company in Serbia.

As well as rising to business challenges, the senior management team had to deal with people-related issues within the company. The team's homogeneity had been decreasing since 1996, and further disagreements became evident in 1998. Deželak was absent for health reasons for the better part of 1997, which contributed to the frustration of some managers about the

clarity of Kolinska's strategic direction. Several members of top management were approaching retirement age and this, while the company had good successors in mind, would stretch management talent thin. In 1999 Deželak decided to rejuvenate the Management Board, promoting two younger middle managers to Management Board members in charge of manufacturing and finance. The new members brought with them some changes in strategy. Kolinska was still committed to balancing the revenues from its cooperation with CPC International with sales of its own brands, but was looking more explicitly for new acquisitions, in particular in beverages, as a way to achieve high growth. The style of management was clearly top-down, with Deželak delegating tasks to others and selecting middle managers based on their ability to deliver results. While the period before 1996 was characterized by relatively intensive, albeit top-down communication within the company, after 1996 the intensity of communications seemed to reduce significantly.

Since business results for 2002 indicated declining profitability, Kolinska's management decided to cut wages by 8%. This generated significant turmoil with the unions, which for the first time since 1991 openly opposed the management. By that time the company had downsized to around 600 people, a process which had created constant fear of job losses. The management estimated that the power of the unions in this situation would be limited, and was able to avoid major disruptions in production without reversing its decision. However, some senior managers felt that the company had reached the limits of pressurizing people, and the company faced ill-motivated employees who remained only because they couldn't find better jobs. For that reason the management began to advocate more investment in education, and the use of more selective HR practices, the result being a pilot project in this area with a local university.

As the key resource needed to successfully implement its strategy, the company throughout this period relied on its ability to continuously decrease costs and improve productivity without compromising its flexible manufacturing process,. It also continued to fine-tune its domestic sales and distribution capabilities. Once the wars in the Balkans were over, regional distribution in Croatia and Bosnia and Herzegovina also became more important. Although Kolinska lost the distribution rights for licensed products in these markets, it could use the network to distribute its own products, which proved extremely beneficial to the growth of beverages business line.

Due to constant downsizing throughout the period Kolinska had not been systematically hiring new talent, and experienced problems finding the appropriate people in the very tight Slovenian management labor market. The middle management situation began to be seen as a barrier to successful further restructuring, impeding both the capacity for organic growth and the ability to acquire companies without a management pool of the appropriate quality.

While the company was successful on the operational side, the company management was critical of performance and ability on the development side. Lack of skills in new product development and branding were seen as an obstacle which not only influenced the choice of strategy but also the quality of its implementation.

Lately, there have been some indications that the new Management Board is coming close to a decision to engage in strategic restructuring. The company has acknowledged that it has exhausted the potential of a licensing business model, and has recently approached a global consulting company for a project on strategic level. It has also established a partial focus on beverages, and seems to be ready to invest in improving the relationship with its workforce

(especially middle management), in the aid of restoring the level of trust necessary to attempt strategic restructuring. However, there is an obvious divide, which reflects age differences, among top management members.

#### 5.2.4 Summary of research findings from the Kolinska case

Two cycles of change can be observed at Kolinska in the period from 1991 to 2003, and there are some indications that the company may be in transition towards a third cycle. The first cycle was clearly characterized by aggressive downsizing and displayed all the features of defensive restructuring. The change was initiated based on a management assessment that developments in the market matched one of their predefined scenarios. An early start, fast downsizing and other cost-cutting measures allowed the company to avoid severe financial crisis despite the huge challenges presented by an initial 70% drop in revenues. The fact that the company had installed a solid management accounting system augmented the speed and accuracy of its reaction. It also limited the potential damage of financial slack, since the company could clearly monitor the “slack burning rate” and act while financial reserves were still high. Thus, the trigger phase of the first change cycle seems to comply completely with the research model’s predictions, Kolinska’s scenario indicating an interesting link between industry dynamics, transparency of performance and the role of financial slack in assessing the need for and the feasibility of change.

The elements of the defensive restructuring organizational template also follow the predictions of the research model. Asset restructuring was attempted, but had no major impact on the restructuring process. The full attention of the company was placed on various elements of cost reduction, primarily significant downsizing. The fact that company also tried to boost revenues does not contradict the research model, since in doing so it did not alter its business model (which would imply strategic restructuring), but merely did “more of the same”, i.e. deployed existing assets and competences to the fullest extent possible. All major decisions were fully centralized at Management Board level. Improvements in quite specific manufacturing and distribution processes were pursued primarily on the basis of company insights, without benefit of outside support or benchmarking with global competitors.

The resources used in the first cycle also largely match predictions. Along with the specific competences of the business model (manufacturing and distribution), successful change was brought about primarily through careful use of financial slack and various institutional links (relationships with retailers which boosted sales, and political support for downsizing), heavy use of the cost-control system, and trust Deželak enjoyed from his employees. The one unclear component is Kolinska’s use of human resources: while the scarcity of this resource matched predictions, it is not evident whether the company exploited well what it had.

Leadership interventions, which Deželak used in the first cycle, also comply with the predictions of the research model. Deželak centralized decision-making on the new strategy and made sure that resources were used primarily for cost-cutting and distribution support. The acquisition of Talis, which may appear a departure from the focused use of resources, did not change company strategy at all. Talis’ product line was close to what Kolinska already had, and the acquisition can be seen as part of the company’s effort to use its existing distribution network most effectively.

Deželak did engage in a significant communications effort with exactly the goals predicted: those of trust building, an explanation of solutions to existing problems, and fear

management. He also used coercion, especially in the second phase of downsizing, to exploit the relatively weak position of employees and speed up restructuring.

As already noted, Kolinska's management did not report significant active opposition to change, despite some institutional pressures related to the speed of downsizing. They noted, however, that lack of skills and knowledge was a major constraint, as well as fear involving job security. These factors were also judged to critically limit the ability of the company to engage in organizational learning.

Once the immediate threat of financial collapse was removed, the management reassessed the need for and the viability of change. It came under the strong influence of industry dynamics: while on the one hand enjoying strong relationships with its licensing partners, on the other it assessed the maturity of the industry as a significant factor arguing against a radical change of strategy. Also, as proposed by the research model, opportunistic behavior did affect the readiness to attempt change. In this particular case it decreased readiness, since the management seemed to be waiting for a "silver bullet" in the form of a particularly successful opportunistic acquisition, without attempting to more thoroughly address the restructuring strategy or build up the strategic reliance on acquisition as a systematic part of it. Several potential options for strategic restructuring were ruled out because of the assessment that the company lacked the resources to implement them (in particular a focus strategy and new product development), although in general the management acknowledged the need for change. At the same time, despite the available financial resources Kolinska's top management launched no effort to fill gaps in competence, which could have changed the situation over time. Finally, decreasing homogeneity at the top and decrease of trust also contributed to the mode of change, which retained some elements of defensive restructuring combined with non-aligned changes.

As predicted by the research model, this situation led to a deterioration of the strategic position. Kolinska is indeed still enjoying a relatively solid financial performance, but it has slipped below industry averages and seems unable to make major progress in building the competences needed for strategic repositioning. Internal communications are far from good and trust in the company leadership is decreasing.

Recent indications of a possible new change cycle show that, for the time being, the two groups differ in their assessment of the urgency of change, which in practical terms means that the trigger level has not yet been reached. Even if the trigger is reached and strategic restructuring attempted, it remains to be seen what course of action will be taken, and whether the company will be able to break the barrier presented by lack of the competences required for the process.

### **5.3 Končar**

Končar is among the largest heavy industry companies in Croatia, with 200 million € of revenues and 4,000 employees in 2002. It is primarily focused on electrical equipment for use in power systems, transportation and industrial applications.

#### **5.3.1 Brief overview of company history prior to 1991**

The company was established in 1921 as an electrical repair workshop and was subsequently acquired by Siemens. It developed steadily, and became one of the leading European companies producing electrical motors, and the first to use lacquered wire in motor

production. At the end of World War II it was nationalized and changed its name to Rade Končar. The company exploited the growing needs of Yugoslav markets in the 1950s, which were driven by post-war rebuilding and the fast industrialization of the country, to widen its portfolio of electrical equipment for power and industrial applications ranging from electrical motors to large electrical power generators, power switchgear and transformers, and control systems.

Based on the political and business philosophy which in those years prevailed in former Yugoslavia, Končar tried to develop as many products as possible by itself. Although some of these efforts were high-cost and used less than up-to-date technology, the approach established an extraordinary base of technical talent, and also influenced the strong development of the technical department at the local university.

In the 1960s the company benefited from opening of Yugoslavia and started its first partnering agreements with companies such as ASEA (now ABB). It also diversified further in industrial electronics, transportation systems (locomotives and elevators) and household appliances, where it formed a joint venture with Zanussi. It also started to penetrate international markets more actively, where it positioned itself primarily as a low-cost equipment provider. Up until the late 1980s the product portfolio became progressively more sophisticated, including complex power and industrial control systems, and turnkey solutions for hydropower and large transformer stations. Rade Končar had a number of production sites in Croatia, as well as one in Serbia and two in Macedonia, employing close to 25,000 people. It reached close to half a billion \$ of annual sales and was very successful in winning major contracts on international tenders, where it could offer technical solutions of reasonable quality at a highly competitive price. Overall, the company was successfully balancing domestic and international sales, but some of its product lines were strictly domestic, while others were heavily international, focusing primarily on the fast-growing markets of developing countries, which lacked electrical industries at international levels of competence. The markets of developed countries like the EU or the USA were regarded as closed and fully controlled by strong domestic producers.

The formal organization of the company clearly indicated a desire to deploy synergies across different product lines. The central R&D institute had more than 1,200 employees, 200 of whom had MSc and PhD titles. Trade services were also centralized, with representative offices in more than 20 countries and a focus on selling commodity-type products. The engineering division with 1,500 employees was in charge of designing, contracting and delivering complex systems such as power stations, and it integrated equipment from some 30 production divisions and bought the rest in global markets. However, significant tensions existed between production divisions and central services, the latter being accused of having a privileged status and of pricing manipulation, which allowed them to live comfortably at the expense of others. The influence of the corporate management had been declining over time, and towards the end of the 1980s practically all power was concentrated in the hands of division managers. At the same time competitiveness in the international markets was being eroded somewhat by the high-speed technological advancement dictated by giants such as GE, ABB and Siemens, as well as by performance problems generated by decreasing levels of employee motivation.

At the beginning of 1990 the company began to experience acute financial problems. Although there had been some indications of deterioration in the previous period, most of the top managers were caught by surprise. Several elements contributed to the problems, but the

most important were the effects of the Gulf War. Rade Končar had traditionally been very active in high-risk countries including Iraq and Iran. In the 1980s the company had experienced problems when it was unable to collect debts in Egypt and Nigeria, but this time the amount of money lost in Iraq was simply too great: \$300 million in equipment and services had to be written off, and 300 people and \$10 million in equipment were blocked on several sites in Iraq. This crisis came just at the time when the Yugoslav banking system crumbled, which not only meant that the company had no access to short-term financing to help it weather the crisis, but also that it could not count on the financing of potential new international contracts. With an escalating political and economic crisis in the country stopping all investments, and country risk growing to intolerable levels for any success in international bidding procedures, the company was also left without a stream of new large contracts. In May 1990 the President of the Management Board died, which left the company floating amid rising turbulence.

The newly-elected right-wing government in Croatia at first showed little willingness to come to the rescue. When the management finally started modest attempts at restructuring, it faced the vigorous opposition of the labor unions, which were backed by the government. With the company facing bankruptcy, a change in top management was agreed on as a precondition for government intervention.

### 5.3.2 Changes in the period from 1991 to 1994

After a short and damaging period of interim top management, characterized by lack of professionalism and complete confusion on the divisional level, the approach to restructuring dictated by the government became clear. A new holding company was created under the name Končar (to exploit the value of the internationally recognized brand name) and Vjekoslav Srb was appointed new President of Management Board. Srb was an industry veteran, with a long tenure in the top management of a large trading company close to Rade Končar, and was experienced in international trade and large projects. He had known most of the senior managers of Rade Končar personally, and invited a few of them to join him on the Management Board of the newly-formed company. Two had been members of the Management Board of Rade Končar in 1990, but others were also representatives of the previous senior management.

Following the model first used in the restructuring of the Slovenian electronic giant Iskra, the Croatian government through its operating agency the Croatian Development Fund established a new legal entity. Physical assets and contracts were then transferred from the technically bankrupt Rade Končar to the new company. Most Rade Končar divisions declared bankruptcy and dismissed all their employees. The management of their “mirror images” in the newly-created company then invited some of these ex-employees to join the new company. Selection criteria primarily involved anticipated levels of individual performance, but were in some cases obscured by candidates’ seniority or personal and political relationships. In some cases divisions felt that bankruptcy was not the best solution and, using the local legislation (which was in state of flux), found ways to transfer ownership from Rade Končar to Končar. Divisions in Serbia and Macedonia were claimed by their employees and did not become part of the new system.

An intentional consequence of the whole process was additional fragmentation of the company, with 55 divisions created within Končar, as opposed to less than 30 before restructuring. Each division was a separate legal entity with a Supervisory and Management Board, and was initially fully-owned by Končar. The company downsized to 10,000



employees, or 40% of its initial size, but in 1991 it also had less than 50% of the revenues it had seen in 1989. The logic behind fragmentation was simple, although questionable. It was assumed that smaller units would show the higher flexibility needed to survive, and that any failures would cause only minor overall damage to the system.

While centralizing the financial area, Srb decided to set up the new company as a financial holding and leave full strategic and operational autonomy to the divisional managers, who were held responsible only for the financial performance of their division. Srb on several occasions publicly refused to create a vision or a more precise strategy on the corporate level, claiming that such an approach would not be effective and that entrepreneurship at the divisional level should be given enough space to produce results. He encouraged further diversification and facilitated the creation of a number of tiny units in new business areas, even though the effects of these efforts continued to be negligible at best.

Several problems resulted from this policy. Lacking a robust management accounting and control system, corporate headquarters were dependant on the information prepared by the divisional management. In practice this allowed for significant distortions, and many divisional heads were tempted to pursue their own interests in total disregard of corporate priorities, and/or to protect their positions by presenting the situation as better than it actually was. Such practices proliferated after the first stage of privatization in 1995, when state funds sold part of the equity to private investment funds and individual investors. Privatization was carried out at divisional level, i.e. investors were invited to become minority shareholders in individual divisions. Apart from a few cases (which included the sale to Siemens of a majority stake in one of the best divisions), Končar retained majority control of the divisions. Divisional managers were encouraged to buy shares, in the hope that ownership would have a positive effect on their performance. In some cases, however, this created significant conflicts of interest. The prices of controlling shares were set high and managers who bought them had problems repaying them out of regular profits. This led to some cases of unethical behavior, which were mostly ignored by the top management.

The totally depressed situation in the local market and poor backing for international expansion, plus the crisis in CEE, all contributed to a miserable sales performance. Since in the past most divisions had sold their products through “common services” (trade and engineering), they lacked the business functions needed by a stand-alone company, most notably in sales and marketing, R&D, and accounting. This made the struggle even more difficult. In most cases divisions could rely only on sales of repair services. In searching for additional markets many divisions started to compete with each other, which was tolerated at the corporate level. Divisions also had to cope with a legacy of declining work quality and low adherence to technical standards. This – less a problem of technical incompetence than of attitude – was gradually resolved when employees became aware of the link between the quality of their work and the security of their jobs. Investment in R&D was minimal, and the research institute was downsized from 1,200 to 96 employees, who were expected to sell their services on the internal and external market and make the unit fully self-financed, like all the others in the system.

The market situation persisted until the end of 1993. In the meantime Končar suffered small losses and continued downsizing, to 7,800 employees.

### 5.3.3 Changes in the period from 1994 to 1998

In 1994 Končar's top management began to understand the negative influence of the company's non-transparent financial holding organization. At the same time it identified some market opportunities arising in the region. However, it had no resources available at the corporate level and retained the concept of a strictly financial holding. More focused controlling was introduced and the holding started to prepare for privatization, with the initial goal of going public in 1997. A leading global management consulting company was hired to perform a thorough portfolio analysis of more than 50 divisions. While better sales performance and the decreased number of employees had improved some of the financial parameters, they were still far away from international benchmarks, ROE remaining below 3% even in the best years (the target was set at 5%, while the best companies in the industry showed figures of 6% to 14%). The results of the analysis indicated a poorly balanced portfolio, and in 1997 led to the spinning off of several divisions and the merger of others, although the overall result was not regarded as good enough for proceeding with the public offering. The consultants, however, refrained from advice implying the need for corporate-led strategic restructuring and the use of synergies across divisions. Instead, they looked at the performance and potential of individual businesses.

Even when the market situation slightly improved, downsizing continued and by 1998 Končar's workforce had been reduced to 4,400 employees. Many of its small units went bankrupt during this period, some more than once.

Throughout his tenure Srb maintained his soft, non-confrontational personal style. He praised a conservative approach to risk-taking and believed in achieving change through a sequence of small steps. He practically never changed the composition of the top management, but the Management Board replaced a number of divisional managers because of the poor financial performance of their units. Srb allowed divisional managers positions of power in dealing with the mother company in all matters except financial performance. He met with them once or twice per year and provided general information about the situation in the holding company, but according to his policy did not enter into more focused discussions with regard to divisional strategies.

Thus, divisional managers were left to themselves to lead change within their territories. Despite differences in personal style, they were all heavily influenced by the company's culture, which for decades had been based around recognition of technical competence, strict hierarchy within smaller units, but relative disobedience with regard to central authority. It is not surprising that took some time for divisional managers and their subordinates to get used to the reporting requirements set by the mother company, and poor communication at top levels also characterized the whole period. However, given the extremely limited financial and other resources, the divisional management soon realized how dependant they were on the motivation and technical competence of their employees, as the only advantage they had in the marketplace. Thus, against seemingly insurmountable obstacles, and despite low salaries and continuous pressures to reduce costs, they used pride and challenge as the main motivators to achieve results. This required intensive communication within divisions, which was seen especially in those that did not go bankrupt and still had active labor unions. Divisions that went through bankruptcy had the advantage of a fresh start, which many used to install more transparent performance monitoring systems for personnel selection and rewards.

#### 5.3.4 Changes in the period from 1999 to 2003

In 1998 Srb and the other members of the Management Board were approaching the end of their second term. Končar was still primarily state-owned, although 18% of its equity had been sold to different private investors on the holding level and an additional 10% to buyers on the divisional level (most of the latter lacking control rights). The results of eight years of restructuring were mixed. On the one hand, Srb was happy that he had succeeded in keeping the company alive and in bringing it to marginal profitability. Some of the divisions were showing signs of true consolidation, had achieved growth above the industry average and had started to work on new, more complex products. On the other hand, the overall number of employees was still decreasing, overall growth of revenues was sluggish, and productivity was still significantly below the levels achieved by global players. Končar was managing to use opportunities for new business arising in the local environment, but had not stabilized its presence in markets outside of Croatia. The Croatian market then experienced a major downturn in 1998, which created new worries about the company's prospects. At the same time, major competitors such as ABB and Siemens were signaling that the industry was entering a very difficult period, mainly caused by the global trend towards deregulation of the power industry and lower levels of investment in emerging countries.

Srb decided to retire at the end of his term, and the government looked for a new Management Board President. The job was offered to Darinko Bago, at that time a member of the Supervisory Board. After graduating in electrical engineering he had joined "Rade Končar" in 1976, where he held various positions until 1991, when he was offered a diplomatic posting and spent the next 7 years as Croatian ambassador to Switzerland, Bulgaria and Bosnia and Herzegovina. Since 1993 he had been a member of the Supervisory Board, and was well aware of the situation in the company. His previous career was marked by high achievement and notable personal integrity, but had also featured his direct, sometimes abrasive style.

Except for the CFO Bago replaced the entire Management Board, mostly with people who had worked with him in his days with the company. He never openly criticized Srb, but made it clear to his colleagues that the previous team had not performed well, mainly because they had no vision and had showed no initiative on the strategic level. He thoroughly analyzed the consulting report prepared two years previously, and came to the conclusion that the consultants, while making a solid analysis of individual divisions, had missed the important synergetic potential across divisions. That became the driving force behind his next actions, which focused on transforming Končar from a financial holding company into a more tightly-run corporate. He declared clearly his opinion that – instead of fostering entrepreneurship and leading to bottom-up driven transformation – allowing further fragmentation and failing to deploy possible synergies would lead to the gradual demise of the whole company. He used several recent examples of large Croatian and Slovenian companies which had disappeared after taking a similar road to persuade his colleagues of the need for a strategy more coordinated from the top.

Among the first moves made by the new team was an audit of divisional results. Significant problems were found in the quality of reporting, and strict measures were taken not to allow this in future, including the improvement of the controlling system and IT support. The audit also showed that the company possessed a significant amount of non-performing assets, and measures were taken to sell them off. The top management did not expect fast results from this, due to problems in the Croatian real-estate markets and the negative reaction of the

government which, as the most influential owner, was afraid of possible wrongdoing and the poor public impression the asset sales would create.

After reexamining the position of all the divisions, Končar's top management came to the conclusion that the firm had the potential to become the leading electrical equipment company in Central Europe. They felt that the strategy which the company had used in its best days in the mid-1980s would again be the best choice. This strategy had assumed that Končar's competitive advantage lay in its high level of technical competence, its flexibility, and its cost advantage due to efficient and low-paid labor. According to the top management, this assumption matched the industry trend towards the growing proportion of low-cost producers, caused by power sector deregulation. Thus the company focused on selling equipment that was produced in individual pieces (e.g. generators) or low-quantity batches (e.g. high power transformers and switchgears), and customized turn-key projects, both requiring a high input of professional expertise and excellent customer relationships, but not state-of-the-art technology. Geographical focus was placed on Central Europe and a few other countries lacking their own strong electrical equipment producers. Privatization of the power industry and other large potential customers (e. g., railways or the petrochemical industry) was seen as an opportunity for Končar to break into markets previously held tightly by multinational companies through their influence at the government level. Those divisions unable to become leaders within their target geographies were to be sold.

To support their argument and to gain better acceptance for it among the divisional management, Končar's top management commissioned global consulting companies to carry out several consulting and market research projects. Based on the experience of the first project, Bago requested very tight coordination of these and personally approved their results, in one case forcing the consulting company in question to repeat a project with a new, more qualified team. The projects confirmed that Končar had a surprisingly strong brand in the whole region of Central and South East Europe, and that some divisions had lately developed new products which approached the technological level of industry leaders. Bago, in order to update the company's know-how in the area and prepare it for several crucial tenders in Croatia, had also requested that the company engage in several bids, although it lacked realistic chances of winning them. Double-digit growth was achieved from 2001 onward, and Končar's share of exports increased to close to 50%.

The top management used their power of influence through the divisional Supervisory Boards to push the creation of larger units, which in their opinion would be more competitive. Through mergers among divisions their number was gradually reduced to 27. However, despite these mergers and the resulting cost reductions, the decade-long downsizing trend was stopped in 1999 and since then the company workforce has remained stable at around 4,000 employees, although its structure has been gradually improved. In addition, the government permitted a reduction in the percentage of state ownership in Končar, which for the first time came down below 50%. Bago prepared a plan to grant more stock options to employees, based on the American experience where ESOP plans contributed to employee loyalty and motivation.

To foster cooperation among Končar's divisions Bago introduced a mediation committee, which was assigned the role of resolving interdivisional disputes. This had become a true problem for the company, even resulting in legal action and 17 cases where individual divisions sued each other. Bago radically cut this practice by deciding that divisional managers who were involved in two unsuccessful internal mediation processes would be

fired. Within three years about 40% of divisional managers were replaced on the grounds of poor performance or unsatisfactory cooperation. At the same time, the company was becoming increasingly concerned about the limited pool of managerial talent, and stimulated the divisions to invest in management development. Given its specific industry, but also the relatively poor image Končar had until recently had as an employer, the company depended mostly on internal promotions or the rehiring of previously laid-off employees, but after almost a decade this practice had reached its obvious limits. Many middle managers, as well as the employees, were showing clear frustration with the duration of the crisis. Rumors circulated about the high personal gains of some divisional managers through either the privatization process or misuse of nontransparent business practices. This situation somewhat decreased the usefulness of challenge as a key motivator, and increased pressures for material rewards. The top management acknowledged these pressures by proposing higher performance-based bonuses for divisional management, indicating clearly that they expected the practice to extend to low levels of the hierarchy as well.

Despite his image as an authoritarian leader, Bago nurtured closer relationship with all the Management Board members. It became an unofficial rule that all Management Board decisions be the result of consensus. Bago also engaged heavily in communication with the unions, which resulted in their placing a high level of trust in the top management. A good example was an occasion when the unions had to enforce a nationwide strike, but consulted with the management and advised union members of a strike schedule which would be least disruptive for the company.

On the other hand, Bago met some resistance from the middle management. Many of these feared his direct style and found his new policies in direct collision with their interests. This was particularly the case in some of the divisions with higher levels of management ownership. While the top management still did not intervene directly in decisions lacking repercussions across divisional boundaries, some autonomy had been lost and it was assumed that this trend would continue. In addition, most of the division managers retained memories of powerful central services, and were convinced that despite its theoretical advantages the approach would not work well at Končar any time soon.

### 5.3.5 Summary of research findings from the Končar case

Three stages of change can be observed in the case of Končar, with the border between the first two somewhat blurred. The trigger for the first phase was the company's deteriorating financial situation. This was noticed late, since Končar's reporting systems were inadequate and it was difficult to gain a full up-to-date view of overall company performance. Management assessment of the situation was also heavily influenced by the nature of the industry, as well as by the political and economic changes in the environment. Finally, the company had just entered a leadership vacuum due to the sudden death of its previous leader. All of these factors were interpreted as highly negative for the likelihood of change, which blocked the management and forced external forces (the government) to take control.

This assessment of the situation, and the mimicking of Iskra as a role model, also influenced Končar's choice of a restructuring model. Its characteristics clearly categorize it as defensive. Bankruptcy on the divisional level (as well as the technical bankruptcy of "Rade Končar", the former mother company) was chosen as the preferred short-term restructuring vehicle. Interestingly, it seems that those divisions choosing not to enter bankruptcy suffered more and needed more time to return to former performance levels, without much difference in the number of jobs saved.

Along with downsizing, most of the other elements of the organizational template match predictions from the research model. Heavy focus was placed on costs and financial liquidity. Asset disposal through the bankruptcy procedure was used as a one-off source of financing to start new activities, although due to the country's poor economic situation and other unfavorable conditions its financial effects were very limited. The divisions focused on the use of available scarce resources and on much-reduced market goals, without any investment in new learning.

The one element of the organizational template which did not match the predictions of the research model was the role of centralization. Although Končar's financial management was completely centralized, in all other aspects the company remained highly decentralized. Several factors had contributed to this state of affairs. First of all, the new top management had no vision for the company, and was thus dependent on the divisional management to come up with visions for their own individual businesses. Secondly, the top management was heavily influenced by legal and financial interpretations of the previous ownership system, in which the major financial problems of single divisions could sink the whole company, even if that division was a separate legal entity. Thus a system was created with minimum dependency among its entities, in the hope that problems would not be propagated from one to another. Thirdly, Končar had a culture of mistrust towards central services and a great desire for divisional autonomy. A strong but incapable center was blamed for past problems, and the divisional management had no trust in any other solution offered.

While the analysis of the trigger and the initial reaction in terms of the new organizational template mostly accord with the research model's predictions, it is also obvious that none of the critical resources identified in the research model was present. According to the research model, this should imply an unsuccessful change effort. Due to the late reaction and the totally non-professional interim management, financial resources had been depleted before the change was even started. Internal control systems were poor. High levels of divisional autonomy reduced the transparency of performance for top management, and the simultaneous lack of company-wide management accounting and control systems and the lack of experienced managers also meant that divisions were left in the dark about their own performance. Given the radical downsizing measures it was difficult to optimize the use of human resources. The shock of the first downsizing phase eliminated nearly all trust in top management and significantly reduced trust in divisional management, but the latter at least had an opportunity to earn it from scratch, especially in the case of bankrupted divisions. Obviously, the top management faced difficult choices in selecting new divisional management: while most candidates with prior experience of leading the business lacked employee trust because they were regarded as partially responsible for the disaster, those with none were more likely to make mistakes, which were difficult to tolerate given the fragile financial situation.

Finally, Končar's top management failed to intervene as predicted by the research model. They chose bottom-up changes; did not engage intensively in communication and trust-building; and were left with coercion as the only way to influence divisional management. The barriers they faced – apart from an extremely hostile business environment – were lack of trust, fear and confusion, and grossly inadequate non-technical business competence.

Most of the components described above were very apparent throughout the period between 1991 and 1998. However, from 1994 the external environment became somewhat less hostile.

In the meantime, the divisional and middle management had accumulated a bit of business experience under the new conditions, and the divisions had improved their business competence. Despite the observation of the top management in 1994 that the new organization was inadequate, no major interventions were attempted and the organizational template did not change significantly. Downsizing continued and most of the attributes of defensive restructuring remained, although this restructuring was carried out without a clear orientation. In this sense it can be argued that a second phase of change had begun which shared characteristics of defensive restructuring and of non-aligned change, defensive restructuring being present in the philosophy of the top management and non-aligned change in divisional management initiatives. One more major barrier to change meanwhile appeared in the context of privatization and poor control systems: an increasing misalignment of interests among divisional managers (especially those with significant ownership interests and/or loan repayment obligations) and other interest groups.

The trigger for the third phase of change was directly related to the change in Končar's top management. It is not clear whether the change in top management itself had resulted from the owners' assessment that more radical change was required, but once it happened it produced a new evaluation of the need for and possibility of change. This evaluation was strongly influenced by industry dynamics and the increased transparency of company performance, but also by the profile of the new leader and his team. This time the assessment was positive, generating a more focused drive towards a different type of restructuring.

The new organizational template was more unique than may be apparent at first glance. It was not created overnight; it included clear strategic positioning of the whole company and required individual divisions to align with it. Although the mother company still lacked resources, it began pushing the divisions to focus on critical success factors, from technological competence and new products to the building of closer contacts with customers and management development. Končar also started to engage more actively in organizational learning surrounding the best global practices, through consulting projects, systematic involvement in bidding processes, and international training programs.

Because Končar still had a very limited financial potential at the start of the new development cycle, the top management capitalized on its quasi-monopoly position in the domestic market and secured several lucrative contracts allowing for learning, gaining access to the new generation of technical solutions, and building financial reserves. Although all of these were won in direct competition with multinational companies and according to regular bidding procedures, a close understanding of, and links with, the customers, plus the high levels of commitment displayed in government lobbying proved extremely important factors.

Significant improvement in the transparency of performance of both individual divisions and the system as a whole was achieved. Use of international consultants as well as investment into IT and strict auditing procedures were all important here. Together with intensified communication, this generated more trust on the part of front line employees and most middle managers. Bago did not shy away from a leadership role, but he kept other members of the top management team involved and allowed the divisional management much initiative. In this way he avoided complete centralization and further resistance from the divisions.

If anything departs from the predictions made on the basis of the research model, it is the higher level of coercion used (primarily through replacement of divisional managers). This can be explained by the growing pluralism of interests and the persistent culture of non-

alignment with the center. Also, Bago was characterized as a stubborn and relatively poor listener, which certainly dampened two-way communication and slowed buy-in of the divisional and middle management, but seemed not to inflict immediate damage on either the trust and support he enjoyed from front-line employees, or company reaction to change. Nevertheless, it put both in potential jeopardy and required Bago to use his personal charisma to push ahead, which eventually made him highly dependent on good company results to buy the necessary time to make changes.

## **5.4 Lek**

Lek is among the four largest pharmaceutical companies in Central and Eastern Europe and among the leading generic drug producers worldwide. In 2002 it had 370 million € of revenues, 2,350 employees in Slovenia, and 1,360 employees abroad. Since 2003 it has been part of Novartis.

### **5.4.1 Brief overview of company history prior to 1991**

In the early period of development after its founding in 1946, Lek used the protected markets of former Yugoslavia to sell its own generic products and gain licensing rights from pharmaceutical multinational companies for production and sales of their products in local markets. After initial success in the domestic market, the company extended its licensing contracts to Central and East European countries, using the agreements allowing for barter trade between former Yugoslavia and COMECON countries. At the same time Lek invested in improving and extending its production capacities, and started its own R&D department, which focused mainly on pharmaceutical products derived from the company's own active pharmaceutical substances plus a few lower added value generic drugs. Patent legislation in former Yugoslavia and the Soviet block countries was process-oriented, which allowed for somewhat less restrictive patent protection and rapid expansion of product portfolio.

By the late 1980s the company was enjoying stable growth and 50% of its sales were in exports. It continued to extend its product portfolio despite attempts by the federal government to impose a strict division of therapeutic classes on the country's six pharmaceutical companies. Along with its core pharmaceutical business Lek developed highly profitable cosmetics, dental and veterinarian businesses, almost exclusively targeting Yugoslav markets.

One key development from the organizational standpoint was the introduction of a long-term planning process. This allowed the company to formulate a strategy for the period up to 2000, which focused on further international growth and balanced development of its own and the licensed product portfolio. In accordance with this strategy, Lek paid substantial attention to hiring pharmaceutical experts and developing close cooperation with Slovenian universities, thus building up its R&D potential.

According to the company documents and statements made by its top management, Lek was aware of the deteriorating situation in former Yugoslavia. In the regular strategy review of 1990 the management estimated that the new situation would require a marketing network of fully-owned subsidiaries (as opposed to sales offices) in other republics of former Yugoslavia, and more emphasis on international sales. For the first time Lek committed itself to entering the US market, and to obtain FDA approval was required to make significant improvements throughout the company, in particular within R&D and production. In addition, Lek decided to change the balance in developed countries between sales of active substances and finished



drugs in favor of the latter. Both moves were to result in higher company margins, as prices on the domestic market were kept far below international levels, while the prices of raw materials corresponded to between 2% and 30% of the drug prices, making raw materials sales a low-margin business.

In the course of initial growth and development the company developed a tight, hierarchical culture focused on achieving planned goals. In 1988 Lev Premru, who was seen by many as the visionary leader and careful architect of Lek's past success, stepped down and passed the company to the financial director, Metod Dragonja. Dragonja was at that time 34 years old, and had spent his whole career in Lek, in various positions within finance.

#### 5.4.2 Changes in the period from 1991 to 1993

By 1992 it became obvious that the management had underestimated the effects of the crisis and changes in former Yugoslavia and the Soviet block. Sales dropped by almost 30%, prompting the decision to reorganize and downsize the company. A global management consulting company was hired in 1992 to help with the process, with two main purposes. First of all, it helped Lek's management to legitimize the need for change and in particular downsizing. Secondly, it brought in additional expertise and the benchmarking data needed for process improvements and reengineering projects. However, the consultants themselves were not expected to devise a new strategy for the company, since the top management strongly believed this would be inappropriate. Thus, they only advised on process efficiencies and optimal new organizational size and structure.

After reviewing Lek's strategy, the company management decided that no major change of strategy was needed in its core pharmaceutical business. Focus was on development of products for the USA and on intensifying efforts to build a sales and distribution network in Central and Eastern Europe, where Lek had to replace previous channels (primarily state-owned importers) with new partners, typically small private distribution companies coordinated by Lek's local sales office. At the same time, Lek also decided to establish its core business as a separate division, to facilitate better focus and more transparent results.

The non-core businesses formed the other division. They had suffered from the loss of the large domestic market and had been forced to turn towards international markets for sustainability. This proved difficult, and results were very slow. However, since the share of non-core business in overall revenues was small, the problem never became a true priority for the company. Non-core businesses were managed at arms' length, and interventions from the top were typically limited to the occasional replacement of business unit managers when results were poor, this often accompanied with small cash infusions from the core business. The ultimate goal was stated clearly: to help the non-core units to become self-sustainable, and then spin them off.

Although Lek underwent significant reengineering and cost cutting processes, it did not decrease its commitment to R&D. The company managed to trim its workforce by 10% by relying strictly on soft measures such as early retirement and voluntary departures supported by severance pay. Comments on how well the downsizing process was managed, and how effective it was differ, with some remarks indicating inferior selectivity. Nevertheless, the general consensus was that it did not significantly hurt the company. Some managers claimed that it had positive effects, since it created awareness among employees that change was required and that job security was not guaranteed. Despite the fear that this engendered, it was regarded as supportive of change, since it reinforced the desired performance-oriented culture.

In introducing the changes described, Lek's management intensified communication with its employees somewhat, but maintained a strict top-down approach, which it regarded as the most suitable for achieving fast reactions and which was obviously in line with company culture.

According to Lek's management, the most important resource in that period was the company's ability to rapidly execute decisions made at the top. Part of this ability was attributed to the hierarchical, top-down culture, while another major factor was the employees' trust in top management and in Dragonja in particular. This trust was based on the historical ability of these to deliver good results and keep promises, and was greatly reinforced by the positive image of the company in the local environment. Also important was the ability of the top management to achieve consensus on critical decisions, and to base them on a solid understanding of the environment, the industry, and the company's current performance and future potential. This ability was the result of the strategic planning process, continuity in the top management, and the role Dragonja had in integrating the process and bridging individual differences within the Management Board. Lek's solid level of professional competence as compared to its major regional competitors in key markets of former Yugoslavia and Central and Eastern Europe was also seen as highly important. Benchmarks were less clear in comparison with other pharmaceutical companies, this to some degree due to lack of information but also to the small sample of comparable generics companies of similar size and specific regional environment.

External obstacles to change included the unfavorable macroeconomic situation, which put pressure on the company through severe market conditions and indirectly deflected its attention from important long-term issues, especially knowledge creation. Also, the first signs appeared of industry pressures related to intellectual property rights protection used as a competitive weapon. Internally, the biggest barriers were identified in the lack of knowledge and in related process inefficiencies. Fear of job loss appeared at all levels in the company and persisted despite the soft approach to downsizing, explicit communication and systemic HR action (such as making clear what qualified an employee to be "technological surplus", i.e. to be made redundant).

#### 5.4.3 Changes in the period from 1993 to 1996

After a period of intense defensive change Lek entered a period of more pronounced focus on growth. The management saw no need for major readjustment of the strategy throughout this period, although it acknowledged the existence of two new major factors influencing the company.

The first was the privatization process. Like all other large Slovenian companies, Lek had entered the transition period as a socially-owned company. Its management showed clearly early on that it would fully respect the new legal provisions governing the privatization process. With Dragonja's financial background and close links with both financial and political circles, the privatization process was handled by a small group of experts and managers from within the company and resulted in an ownership structure fairly typical of large Slovenian companies. Two parastatal funds were the largest shareholders, and the rest of the shares were divided among a small number of private investment funds and a large number of individual investors (which included virtually all Lek's current and former employees). 50% of the newly-appointed Supervisory Board by law comprised employee representatives, which further strengthened internal influences. However, the influence of its

new owners and the Supervisory Board on Lek's company strategy was not obvious in the initial period, since they never interfered with the strategic decisions made by the Management Board.

The second important external factor which Lek's management decided to consider was a change in regional policy on the part of the major pharmaceutical multinationals. After the initial changes in Central and Eastern Europe, almost all of these had decided to start dealing in the region directly, eliminating intermediaries such as Lek had been. To do this they gradually revoked licenses for production and sales of their products. This in turn forced Lek to further intensify its own R&D efforts – which resulted in the first ever USA approvals of finished pharmaceutical products to be awarded to any pharmaceutical company from Central and Eastern Europe. Given its limited resources, part of Lek's reaction was to focus on strategic product groups and markets (primarily CEE, but also US). The company also furthered its process improvement efforts, intended to secure a better cost position and improved flexibility and time-to-market capabilities.

Lek's general orientation towards generics was not questioned, since the management interpreted global trends in the industry as favorable to the growth of generic business. They noted, however, the difference between US/UK markets, where generics prices depend very much on an exclusivity level, which after patent expiration generates very low prices in more competitive situations, and other markets (including CEE), where it was possible to brand generics and charge somewhat higher prices.

The management understood that, given the nature of the industry, many concurrent activities were required to secure long-term growth based on predicted industry dynamics. They felt confident to pursue the course, and to wait at least three to five years for results.

Lek continued to rely on top-down communication and the strong support which Dragonja enjoyed among employees. The management prepared for a new strategy review in 1996 determined to maintain detailed five-year planning despite the intensity of change in the environment. To facilitate adaptive implementation and fast reaction to changes requiring strategy readjustment, and to cope with the numerous improvement activities, they focused on project management as a tool to operationalize decisions made at the top. Management Board members were made responsible for key projects, with project groups then staffed with middle managers and professionals. While the top management set clear and measurable project objectives, it was left to project teams to come up with solutions to the problems they encountered during project implementation. If they needed human, financial and other resources, they were expected to produce detailed arguments and convince top management to allocate them. Pressure on performance increased, and more middle managers lost their positions. Although they were not hurt in any other way (e.g. they were even allowed to retain their salary levels after demotion), these people typically had to wait a long time for another opportunity. This increased the level of internal competition, further stimulated by renewed hiring and development of young talent, both in technical and commercial areas.

The 1996 strategy review confirmed the validity of the general direction the company was taking. It also indicated that significant growth opportunities existed, including options for external growth, but that the company might need a strategic partner to exploit some of them. If it relied on its own resources, the company had in principle to deploy the same set of competences identified in the previous period. More focus was placed on the quality of the distribution network in Central and Eastern Europe, as well as on R&D capability.

Additionally, project management competence gained in importance as project management had been selected as the primary tool for strategy implementation and change management.

Barriers to change also did not significantly change in this period. Increasing pressures from multinational companies acted as a major external constraint, while lack of knowledge remained an important obstacle, although major progress was made in terms of organizational learning (more basic levels were mastered and new areas opened, especially in R&D, international management etc.). Finally, it became clear that middle management was a potentially greater barrier to change than were front-line employees. This was mainly due to Lek's performance-oriented company culture, which left little room for mistakes, thus generating great fear of non-performance and, accordingly, a few deviant behavior patterns.

#### 5.4.4 Changes in the period from 1997 to 1998

Having announced no major change in strategy in 1996, Dragonja left Lek to become Minister of Economic Affairs. He was succeeded by Vojmir Urleb, previously in charge of pharmaceuticals sales and marketing. Although initially supported by the Supervisory Board, Urleb soon came under pressure from various internal and external stakeholders fighting for influence over the company. He failed to homogenize the Management Board and maintain a good relationship with Supervisory Board, and was eventually forced to step down. He was replaced by Andrej Ocvirk, a former minister and senior executive of the national oil company.

Although an experienced manager, Ocvirk was at the same time a complete outsider to the pharmaceutical industry and to Lek. Therefore he did not try to make any significant changes to the strategy in the short run. He managed to retain the staunch support of the Supervisory Board, but failed to win the trust of the senior and middle management, especially when it became obvious that he intended to change the company's value system by, among other things, deploying the power of employee Supervisory Board delegates and of the workers council. He allowed them high informal influence, which created a leadership dichotomy.

Along with the growing leadership crisis, Lek was in 1998 hit by three relatively unexpected external events which forced the company to react. The Russian crisis had an immediate, negative impact on Lek's cash flow and projected profits, necessitating a decision: whether to emulate the majority of pharmaceutical multinationals and significantly reduce risk exposure in Russia; or to remain, do business as usual and hope to collect the receivables at some later date, with the increasing probability of bankruptcy for some partners.

Another blow came from Japan, where Lek was dragged into a lawsuit over alleged patent violation and had to decide whether to fight the case or opt for a relatively costly settlement (Lek eventually decided for the latter, through fear that the company lacked enough legal expertise in the intellectual property area to enter the battle; the settlement caused a major write-off against 1998 results). Finally, the FDA questioned the quality of Lek's clinical testing and revoked already-issued approvals for products sold in the US market, resulting in a costly recall of the products already in distribution channels, and stop of the sale.

The senior management did not agree with the way Ocvirk handled the crisis. Arguing the poor 1998 results, they pressured the Supervisory Board to oust Ocvirk, and Dragonja was asked to return to the company.

Looking at this period it is fairly obvious that the company lost internal trust as its critical resource, as well as the ability to reach consensus at the top and orchestrate fast execution. Lack of alignment at the top also led to growing diversity of stakeholder interests, and the resulting power struggle became a major obstacle to change.

#### 5.4.5 Changes in the period from 1999 to 2003

Dragonja and his team claimed that the 1998 crisis demanded no major departure from the previously-set strategy. Nevertheless, the company did make several important changes in its approach to strategy execution.

While the company decided not to pull out of Russia, it acknowledged the need to run CEE operations more tightly than before. This led to further strengthening of Lek's subsidiaries throughout the region, including new acquisitions and an increase in manufacturing capacity outside of Slovenia (a move partially in anticipation of Slovenia's accession to the EU). The governance of subsidiaries was centralized and formalized, thus decreasing the risk of surprises.

Taking a more cooperative stance with the FDA, Lek soon provided enough information to eliminate doubts and regain its product approvals. Then it decided to avoid intermediaries and build its own sales organization in the US, justifying the move with extremely tight margins. However, this demanded a build-up in volumes, plus further improvements to process efficiency within the company. ABC costing was introduced to facilitate process improvement and tighter cost control.

The Management Board felt comfortable with project management as the key tool pushing the ownership of strategy implementation down to middle management level. In addition, they introduced the balanced scorecard and annual interviews for the top three levels of management. Although feedback indicated a certain lack of skills at all levels in setting concrete goals, the new systems were generally regarded as reinforcing communication between Lek's top management and the rest of the company.

Finally, the top management began to pay considerably more attention to risk management. This was seen as especially critical, since the company had returned to high annual growth rates of 20–30%, which threatened to deplete the available resources. Human resources were stretched thin despite the intensive hiring and development of young talent, some employees being offered managerial positions early on in their careers. Financial resources were regarded as even more critical. Assessing growth potential and its associated risks, the Management Board concluded that Lek had serious resource constraints, hindering the company from fully utilizing the potential of its product portfolio, especially in US and European Union markets. They also felt that the strong sales and distribution network in CEE might benefit from a wider product portfolio than Lek could provide in the near future. Finally, they observed that new technologies were demanding further specialization in R&D, and that this would eventually increase risks for companies in the area. At the same time, Lek's owners stated clearly that they expected Lek to continue growing at high rates and with improving returns.

This analysis prompted Lek's top management to commence an active search for a strategic partner. Although this was fully in line with the strategy articulated back in 1996 and approved by the Supervisory Board, it was decided to prepare the project in full detail before making it public. A small team worked on it, eventually concluding that Novartis would be an ideal partner. All the details were worked out with Novartis' management, the deal heavily

influenced by Dragonja's confidence that he could persuade key stakeholders to accept Novartis, provided that Novartis and Lek acted responsibly in their partnership and observed vital stakeholder interests. Then the top management made a public announcement of Lek's intentions and on the same day mounted a major internal communication campaign focusing on the benefits for Lek, and addressing the predictable concerns of the employees. The latter's main concerns were in the areas of job security and loss of identity. According to the interviews, some doubts remained despite the campaign, but employees granted their support to the deal because of their trust in Dragonja and in the sound judgment of the Management Board. As a result, the association of employee shareholders issued the recommendation to its members to sell their shares to Novartis.

The media and Slovenia's general public reacted very negatively to the announcement, questioning the need to sell the company and voicing concerns about the consequences of foreign ownership, both for the company and the local community. Major shareholders also had reservations. To great surprise, despite Dragonja's excellent links with the political elite, both parastatal funds declined to sell their shares to Novartis at the conditions offered, thus effectively blocking the takeover. However, Lek's management persisted and, after additional lobbying and a price increase Novartis managed to acquire the company and start the integration process.

Once again, Lek's top management relied on proven tools to manage the change. It engaged in heavy internal top-down communications, explaining the set goals related to the integration process, which was limited to two years. Joint project teams were established with Sandoz, the generics unit of Novartis. These were charged with operationalizing the integration strategy. Since Lek was of a size similar to the biggest Sandoz companies, its integration resembled a merger much more than a takeover. After identifying the quick wins possible over the first six months, the focus shifted to realizing growth synergies, the prime motive for the partnership. Establishing a joint business plan for 2004 was the main target, with work on a joint mid-term strategy to begin immediately afterwards. It was made explicit that convergence of cultures was not an objective of integration.

Examining the key resources in this period of Lek's development, the top management was unanimous in identifying several complex competences: R&D capability in the generics area (including intellectual property rights know-how), process efficiencies (including performance transparency and various areas of process know-how), a high-potential product portfolio, brand and distribution strength in Central and Eastern Europe, and a significant level of self-confidence combined with the readiness to learn. Homogeneity at the top and the ability to orchestrate fast execution despite fast growth in size were also indicated as critical organizational competences.

At the same time, most of the senior managers agreed that some of the competences had negative sides, too, in increasing barriers to change. In particular, the result-oriented culture limited readiness for true experimentation and innovation in business terms. Bottom-up communication was not of the same quality as top-down, and there were high stress levels among middle managers related to fear of non-performance. Lack of specialized knowledge and experience, especially as to global business within a large multinational, was also seen as a potential barrier to successful strategy implementation.

#### 5.4.6 Summary of research findings from the Lek case

Four cycles of change can be identified in the recent history of Lek, one of them having the attributes of defensive restructuring, two those of strategic restructuring, and one the prevailing characteristics of non-aligned change. It is worth noting that the company nurtures a strong culture of evolutionary change and had already begun the strategic restructuring process in the 1980s. Thus, Lek's defensive restructuring can be seen as a reaction to specific circumstances, after which the company returned to the strategic restructuring mode. Because of the nature of the industry, which is – even for generic companies – driven by long product development cycles and characterized by relatively high returns, none of the change cycles incurred dramatic shifts in the strategy. Both non-strategic restructuring periods were relatively short, and during them the company managed not to undermine its strategic market position severely or compromise its core competence. Although both periods stemmed from deteriorating financial performance and generated redundancies (in the first period they took place mostly at the bottom of the company, while in the second period they affected the very top), Lek maintained enough financial strength to continue investing in R&D. However, it is noticeable that R&D performance and the company's overall learning capacity were impaired during these periods.

The trigger for the first phase was the top management's interpretation of Lek's ability to sustain business despite its relatively solid initial financial position. The assessment was influenced by the nature of the industry as well as by lack of transparency as to performance of core versus non-core activities. A trusted leadership contributed positively to the start of the change, while financial slack slowed down the initial reaction but supported the change once it began.

The organizational template was altered in terms of strategic focus (which was placed more clearly on core business and Central and East European markets), organizational design (divisional organization to facilitate performance transparency, but a high level of centralization within it) and tactical implications (cost reduction through reengineering and downsizing).

The evidence from the first change period fully confirms the predictions of the research model as regards critical resources and leadership interventions. As regards resources, it is worth noting that the nature of the industry and the soft approach to restructuring also left room for use of resources aimed at adding value, not just reducing costs. As in some previous cases, strategic uncertainty was not observed as constituting a barrier to change, although other predicted barriers were present.

The third cycle of change is particularly interesting from the research model perspective. It shows the company passing from a strategic restructuring mode of change into a non-aligned change mode. The top management itself was changed, thus producing alterations in the organizational template despite the assessment that no major changes in the strategy were necessary. With differing assessments among top managers as to the meaning of external events and the company's ability to cope with them, Lek was left without a consensus regarding the need and direction of change. Only once the middle and some of the senior managers had assessed the need for change as urgent was the next cycle of change triggered, despite its seemingly meager chances of success (lack of Supervisory Board support and the resistance of the public media). This cycle also confirms the importance of trust as a critical resource: the faction within the top management who managed to build the trust of key

stakeholders (including middle management and front-line employees) not only won the power struggle, but was able to proceed with the desired changes.

As implied above, the transition to strategic restructuring between the first and the second as well as the third and the fourth cycles of change was triggered primarily by management assessment that there was no immediate need for defensive reaction, but that, at the same time, the environment required changes. Although a vision of the future was not stated in a particularly powerful, dramatic way, it was clear enough to serve as a frame for the strategy. It also allowed for changing interpretation of priorities. For example, in the second phase the scope of business was obviously defined as international with a focus on CEE and the USA, while in the fourth phase it took on a more global character.

All three elements of the organizational template predicted by the research model are clearly identifiable in Lek's strategic restructuring. Along with clear strategic positioning (as a global generic company with value adding capacity), explicit references were made within the company to elements of the value chain supporting the position from the cost and value adding perspective. Learning from the benchmarking carried out by the hired consultants as well as learning from Novartis confirm the (least obvious) third prediction. All the critical resources needed to successfully implement change as predicted by the model can also be identified as important in Lek's case. Naturally, they are complemented by a few specific competences related to the industry and the business model.

As regards leadership interventions, project management as used by Lek can be interpreted as a form of bottom-up change management and a participation-building mechanism. This confirms the presence of all three interventions. It is interesting to note that Lek also demonstrated an intervention not foreseen by the research model: the removal of non-performing middle managers.

Finally, barriers for change during the strategic restructuring phases in essence accord with the predictions of the research model, with the exception of a growing pluralism of interests which, although present, was not seen as a major barrier to change. Change fatigue was noticeable, but was to a large degree eliminated as a barrier by the high implicit reward potential of the "merger" with Sandoz, as well as through the relatively high frequency of changes in middle management positions.

## **5.5 Ljubljanske mlekarne**

Ljubljanske mlekarne is Slovenia's largest dairy company and is among the country's largest food business. In 2002 it had 180 million € of sales and around 1,000 employees.

### **5.5.1 Brief overview of the company history prior to 1991**

Ljubljanske mlekarne was established in 1956 as a small dairy serving the needs of the farmers' cooperative in the Ljubljana region. It was started as a milk bottling facility, but soon extended its product portfolio to yogurts, creams, cheese and ice-cream, adding the necessary simple production technology.

After about a decade of non-ambitious development the company decided on its first major technology overhaul, introducing long-life (UHT) milk based on up-to-date western production technology. This allowed the company to extend its geographic reach and enter markets throughout former Yugoslavia more aggressively. It soon launched the Alpine milk



brand for its UHT milk, which became one of the best-recognized brands in former Yugoslavia. In 1969 Ljubljanske mlekarne continued its expansion by merging with two small regional dairies in Slovenia, while in 1970 it merged with two mid-sized dairies in northern Serbia and created its own retail network. In accordance with former Yugoslavia's dominant economic policy in the early 1970s, Ljubljanske mlekarne became part of a larger system under the name of KIT, created with the idea of vertical integration and including farms, dairies and retail.

The demand for dairy products was growing and the company continued its slow expansion until the end of the 1980s. Although present in markets outside of Slovenia, a significant majority of its sales were still local. It was the largest dairy in Slovenia and was well recognized for the quality of its products. While the purchasing price of raw milk and the market prices of fresh and UHT milk were dictated by the state, the prices of other products were not regulated, which allowed the company to achieve reasonable margins.

Since the markets were protected by highly restrictive import regulations which banned imports of many dairy products, as well as by high customs tariffs for the others, Ljubljanske mlekarne had to compete only with other local dairies. By and large, these were technologically far behind Ljubljanske mlekarne and could not match its product quality, making the latter a major differentiating factor in the markets. Thus, throughout the growth period the company's main focus was on maintaining the production technology advantage, while marketing was significantly less developed. Both purchasing and sales logistics were also quite rudimentary, since the achieved margins did not require true focus on cost optimization and retail was relatively dispersed. While the performance of individual parts within the KIT system was not very transparent, by the mid-1980s it became fairly obvious that the dairy was not achieving good financial results. The KIT system fell apart in 1985 and the dairy remained part of Merkator, the retail chain that had been formed within the former KIT system and to which the company also contributed its own retail network.

Under the influence of the local political elite, Merkators' top management appointed Mihael Urbanija as general manager of the dairy. His background was in finance, and before coming to the dairy he had served as the manager of the internal bank which was part of KIT and later Merkator. Using a conservative approach to financial issues, he soon consolidated the company's financial situation and became the undisputed leader of the company despite his autocratic style.

In 1987 the political situation in former Yugoslavia had already deteriorated significantly and tensions appeared between Serbia and Slovenia. The Serbian units decided to split off from the dairy and regain independence, which was not a problem under the legal system of the time. Since the units in question were operated in a fairly autonomous way in any case, the split did not significantly hurt the dairy's performance. Despite political problems, sales of UHT milk and other products in other republics of former Yugoslavia remained relatively strong, making up about 30% of overall revenues.

#### 5.5.2 Changes in the period from 1991 to 1998

In 1990 and 1991 Urbanija and his team analyzed the changes in the environment devastating many Slovenian companies. They foresaw two different principle outcomes. On the one hand, it was already clear that Ljubljanske mlekarne would lose its market position in Serbia and suffer from smaller sales in other republics of former Yugoslavia. This would create some problems for the company, because the portion of revenues coming from those markets was

expected to shrink by some 10%, which would negatively impact capacity utilization of the production plants in Slovenia.

On the other hand, Slovenia was to become a separate country with its own farming policy and import regulations. This was regarded as a major opportunity to increase sales in the local market, especially in the cheese segment. Also, the EU's relatively liberal import policy, still valid in the early 1990s, allowed the company to export fresh milk to Italy. The management estimated that the overall balance of external factors would, at least in the short run, be rather unfavorable for the company, but would also not require major change to the business model. Being part of the retail chain also guaranteed a safe (although limited) distribution network and no liquidity problems. Thus, while proclaiming a hiring freeze and some other minor cost-cutting measures, the management kept its focus on production and local sales as the key areas for the company.

In 1992 Urbanija started discussions with Merkator's top management, which led to agreement that both companies would be better off if the dairy became independent. Thus on October 1, 1992 Ljubljanske mlekarne was established as a fully independent legal entity.

Urbanija believed that size mattered, a conviction aligned with his strong ego, so he began another round of investments in technology improvement and capacity upgrades, as well as an intense quality improvement program which resulted in an ISO 9001 certificate. Because of the strong influence of the farmers, an increase in capacity was also seen as the only possible reaction to the increasing production of raw milk in Slovenia, despite the fact that demand for dairy products in local markets did not match this increase and that exports were mostly of commodity products like fresh and powdered milk, at relatively low prices which generated losses even after government export subsidies.

The increase in capacity was not matched with product portfolio improvements. Brand and product management were virtually nonexistent, which led to a poorly-balanced product portfolio and gradual loss of market share in some important categories, especially in higher added value products like ice-cream and yogurt. Markets began to open up but the company did not react to increasing competition, even after 1995, when foreign rivals became quite aggressive. The company's top management proclaimed the need to bring new products to the market, but did little to truly improve the performance in that area. Marketing and R&D had little organizational weight, as opposed to production and domestic sales organization, while a totally restrictive hiring policy did not allow the company to develop competence in those areas.

The gradual concentration of retail, especially after 1996, required improvements in distribution. These were implemented relatively successfully, which enabled the company to keep distribution of the whole range of products in its hands, earning additional margins. Ljubljanske mlekarne even used the situation to start distributing non-competitive products for foreign dairies and other food companies.

Urbanija requested his subordinates to prepare worked-out feasibility studies for every single improvement project, in production as well as in other areas of the company. He had an excellent understanding of the industry, an eye for detail and the willingness to spend a significant amount of time checking the plans. His detailed questioning generated resentment from the middle management, hampering the latter's willingness to take initiative. In the end it had a negative impact on the speed of the projects, but also ensured that no major mistakes

were made. Urbanija was aware of some problems at the middle management level, but mostly blamed them on the incompetence of individuals.

In 1998 the company completed the privatization process. As opposed to the situation in most other industries, the privatization of dairy companies was highly regulated and gave priority to farmers' cooperatives, allowing them to obtain significant shares in Ljubljanske mlekarne. Thus, milk producers became the single most important group of company shareholders, followed by the state, investment funds and small shareholders (mostly employees and company retirees).

During the 1990s Urbanija drifted into a more autocratic style of management, which was pushed to an extreme when he developed an illness that greatly impaired his management capabilities. The company's middle management began to fear his volcanic reactions and avoided communicating with him unless he demanded it, which soon created a pattern of strict top-down communication throughout the company. Relations between departments worsened and teamwork practically disappeared, since most of the managers were concerned only with protecting themselves from accusations of poor performance. It did not mean much that the accusations were not followed by sanctions; Urbanija's intimidating style was seen as punishment enough. Erratic promotions, mostly based on Urbanija's personal preferences, contributed to the further weakening of top and middle management, and only a few individuals had the appropriate professional competence and were willing to take initiative within their own areas.

#### 5.5.3 Changes in the period from 1999 to 2001

Ljubljanske mlekarne became a joint stock company but was not listed on the stock exchange, and trading of its shares went on only through brokerages. This relieved the company of short-term worries about its share price. Urbanija successfully lobbied the company's owners to appoint a friendly Supervisory Board and subsequently made considerable efforts to manage the relationship with it. Detailed planning procedures, already developed in the previous period, were used to prepare the company's annual as well as its mid-term plans. However, the focus seemed to be more on extrapolative than strategic planning.

Urbanija soon discovered that not all the owners had the same interests or willingness to engage with the company. He managed to keep under control those Supervisory Board members who were employee representatives, and did not see much of the initiative taken by the representatives of the government and municipality. On the other hand, pressures began from the farmers and the investment funds, but each in a slightly different direction.

The farmers were primarily concerned with the quantity and price of the raw milk Ljubljanske mlekarne was purchasing, and pushed for more production. They used their political influence well: the party representing the farmers was, after all, throughout the 1990s the most active player on the political scene in Slovenia, often changing sides and skillfully securing the interests of its constituency in political bargains. With Slovenia's imminent accession to the EU it was clear that the country quota for milk production would be assigned at or below the level of production at the time of accession. Therefore the farmers increased production to significantly above what the Slovenian market needed. While Ljubljanske mlekarne had already been forced to accept this game by the mid-1990s, it escalated towards the end of the decade.

The investment funds saw their position in Ljubljanske mlekarne as safe, but felt that it brought relatively low rates of return. They did not push to increase their shares, nor did they show a desire to sell over a short period of time. They did signal, however, that they would be happier if the company did something to improve returns, primarily through using economies of scale or by diversifying into more profitable lines of business within the food industry. Although previous experiences with diversification into water and ice tea had not been financially successful, the idea was kept alive.

Urbanija saw an opportunity to satisfy both groups of owners in taking over smaller regional competitors. He targeted two out of the five largest dairy companies in Slovenia and orchestrated mergers. Although attempts of this nature in Slovenia were highly sensitive politically, as there was great anti-Ljubljana sentiment in the regions, Urbanija skillfully played on the threat that EU accession posed for small dairies, as well as on the financial weakness of the companies targeted, and convinced them of the advantages of consolidating under Ljubljanske mlekarne's wing. The company's excellent image and good political connections, supported by the influence of the farmer-owners, helped to complete the process smoothly in 2001.

Additional capacity significantly increased the company's operating costs. Given low utilization rates in the newly-added plants it was completely obvious that the company should consolidate production and close the smaller ones, but also take other cost-cutting measures. One was to decrease the price of raw milk, which was substantially above the EU average. This was bitterly opposed by the Slovenian farmers association, which claimed that the dairies had profits high enough not to require price decreases but to actually support increases. Thwarted, they took to the streets with heavy tractors and blocked all the access roads to Ljubljanske mlekarne, generating estimated company losses of 2 million €. Despite negative public opinion and considerable media pressure, the farmers used coercion and skillful lobbying of the government to obtain concessions from the dairies.

In 2000 the main production plant of Ljubljanske mlekarne temporarily lost its export permit for the EU. Although this did not significantly affect the company's immediate financial position, it provided another signal that further efforts in the purchasing logistics and production areas were needed, and that the competences existing in the company were not producing results because of poor climate and inappropriate management. Urbanija continued to exercise his highly autocratic style without making any strategically-important decisions. His health deteriorating, and in the face of major challenges involving the consolidation of the company and its integration into the EU, as well as poor cooperation with the middle management, he decided not to renew his term when it expired in May 2001. However, to secure his future influence on the company he named Matjaž Vehovec, a member of the middle management team, as his successor.

#### 5.5.4 Changes in the period from 2001 to 2003

The Supervisory Board duly appointed Vehovec to succeed Urbanija, and asked him to prepare a mid-term strategy for the company. Vehovec had spent 13 years with Ljubljanske mlekarne in various capacities: expert in food technology, head of farm production and marketing director. He did not belong to the top management, but was the only member of a wider group with both a degree in and significant experience surrounding food technology, and an advanced degree in business and solid experience in all the company's major business processes except finance.

Vehovec decided to sideline all the members of the previous top management team, including Urbanija, who stayed on as advisor. This created some tensions, especially when Urbanija realized that he was losing his influence, but Vehovec firmly concluded the process within a few months of taking over the company. He replaced the “old guard” with two colleagues from middle management and hired a new executive director for sales and marketing. The new team engaged in extensive discussions of new company strategy, and tried to make a realistic assessment of strategic challenges. At the same time, they were aware of the different interests of the various groups of owners and tried to find solutions which would not provoke direct confrontation.

Vehovec and his colleagues identified several key external forces that, in their opinion, required immediate reaction by the company. Looking at what had happened to Austrian dairies after accession to the EU, they concluded that there would be significant pressure on domestic market share, probably resulting in a 15-20% decrease in domestic sales. They also concluded that a major consolidation of farmers was likely, which would result in a significantly lower number of milk producers but also in increased quantities per producer. This development would have a positive impact on purchasing logistics, but would also increase the negotiating power of the remaining farmers.

Another important prediction concerned growing pressure from retail chains. Ljubljanske mlekarne observed rising pressure from this quarter, and especially from substantial consolidation within Slovenian retail, where the largest customer already accounted for close to 40% of domestic sales. It was probable that the company would have to become more active in brand and category management, and show more readiness to introduce private labels. Also, the largest retailer began to consolidate its logistics, and the top management estimated it was only the matter of time before Ljubljanske mlekarne would be forced to give up its own logistics (except perhaps the cold chain). This would also mean that the profitable business of distribution for other food companies would be lost.

The next area of expected changes concerned Ljubljanske mlekarne’s position in the region. This topic provoked the most controversial debate and it took the management almost two years to reach a consensus. On the one hand, the company had had significant experience in the markets of other countries of former Yugoslavia. In the 1990s it had maintained an indirect presence in Croatia and Bosnia and Herzegovina, working through agents and distributors in order to minimize risk. Vehovec concluded that it was time for the company to establish its own subsidiaries in these countries, but also that it should consider buying a local dairy or even starting greenfield production. The management forecast major trade barriers between Slovenia and countries of former Yugoslavia once Slovenia joined the EU, making local production the only feasible strategic means of staying in the market with low margin, price-sensitive products such as milk. Although this preliminary conclusion was arrived at in late 2001, by mid-2003 Ljubljanske mlekarne had still not yet set up its own production facility, since the company was seeking the optimal way of doing so and was suffering a severe management bottleneck in moving forward.

Another factor influencing this discussion was a scandal resulting from inappropriate use of antibiotics by a small group of Slovenian farmers. Although the quantities found in raw milk never presented a health hazard and the company managed to keep all of its products free of antibiotics, media reporting of the scandal was out of all proportion and badly damaged sales throughout the region. While domestic sales returned to normal levels after a while, exports suffered to the extent that the management had to consider dropping the Alpine milk brand in

Croatia and Bosnia and Herzegovina. The incident confirmed the vulnerability and potentially high cost of brand support in those countries; and combined with extreme price sensitivity, relatively low demand for certain product groups and increasing competition, the management concluded that the two markets had only limited potential. Therefore, they looked for another able to absorb some of the necessary quantities dictated by the high raw milk production levels in Slovenia, and decided to enter the neighboring market of north-east Italy. However, as of mid-2003 no concrete actions had been taken in that direction.

Another major strategic issue under discussion by the top management was whether to build the future strategic position around a strategic partnership or to try to remain independent. Obviously, a decision would also have an impact on the future ownership structure. Various possibilities were discussed, especially since Lura, a Croatian competitor of similar size, had made a public approach to Ljubljanske mlekarne in 2003, stating its interest in buying the company. Several other companies, including a major multinational, had showed similar interest. Although no decision had been made as of mid-2003, the management had clearly indicated that a top priority was to select and present to the Supervisory Board the optimal model for future development.

The demands of increasing competition and pressures in the domestic and export markets made the management move fast in its efforts to optimize internal business processes and achieve a better cost position. Consolidation included downsizing through retirements and voluntary departures, but also several business optimization projects, such as consolidation of production into three out of its initial six locations. For the first time the company addressed marketing issues systematically, among other things reshaping its visual identity and consolidating its brand and product portfolio. More focus was placed on new product development, but with limited short term results. Detailed analyses of the market situation were prepared for all product groups, with the aim of creating mid-term strategies per product group. However, these analyses suffered from too much extrapolation and lack of clarity in the implementation of new regional strategy. All the projects were supervised from the top, but required the intense involvement of the middle management, although some of the latter complained that they had little influence over key elements of the strategy they were preparing. External consultants were brought in for more demanding projects, with those of a global management consultancy focusing on improvements in logistics, the most complex process within the company.

In parallel with consolidation efforts and the preparation of first drafts of new strategic plans, the company began a project to introduce a new ERP system. Vehovec and his team believed that the detailed reporting formats introduced by Urbanija had obscured the true performance of individual business lines, and wanted to improve the use of information in decision-making (and possibly rewarding, although that was not the immediate goal), as well as generally improve internal business processes through heavier use of IT.

In the initial phases of intense project work it became clear that some middle managers had problems adapting to the new style of work, which placed more emphasis on teamwork and initiative-taking. Vehovec decided to invest further in management development, but also engaged in redesigning the organizational structure and finding the best people for different positions. This proved to be a major challenge, since a decade of restrictive hiring and inconsistent HR decisions had significantly depleted the talent pool, while attracting new talent was difficult in the small Slovenian labor market and in view of the company's not-overly-competitive offering.

Vehovec seemed to truly believe in teamwork, and despite his excellent understanding of the business on both strategic and tactical levels and the fact that Ljubljanske mlekarne was one of the rare large Slovenian companies with a one-man Management Board, he depended fully on the other members of the top team in making all the critical decisions. He communicated assiduously with the Supervisory Board, and lobbied externally, but also increased the time he spent with middle management. However, some managers regarded his non-confrontational style and cautious decision-making as a probable cause of the relatively slow implementation of some key projects. Vehovec, on the other hand, saw two critical obstacles to faster change: strong and diverging owners' interests, including a potential conflict of interest on the part of the farmers with their influence in Slovenian politics; and lack of talent in the middle, which he found difficult to change fast. Although he believed that top management had to produce answers to these problems, he also believed that pushing against the will of major stakeholders would eventually damage the company rather than generate change.

#### 5.5.5 Summary of research findings from the Ljubljanske mlekarne case

Three different phases can be observed in the case of Ljubljanske mlekarne, and there are indications that a fourth phase is just being entered. The first phase was clearly in the period from 1991 to 1998, when the company modified its organizational template from that of the previous period, but only to a minor extent. In Urbanija's assessment, the changes in the environment did not demand any immediate reaction beyond a bit of cost focus and an informal hiring freeze. He was influenced by mixed signals concerning industry dynamics and the financial situation of the company, by problems with the middle management, and by his aspirations to be the industry leader in Slovenia. Thus the company engaged in some improvements but did not depart from its production orientation and the fairly local business model. It is interesting to note that the amount of organizational learning during this period seem to have been extremely limited, to a large degree as a result of Urbanija's intimidating leadership style.

The second phase was triggered by privatization, the assessment Urbanija made of the future of the Slovenian dairy industry, and his continuing desire to be the industry leader. He believed that the company had limited but sufficient resources, although he obviously concentrated primarily on financial and production resources, as opposed to human resources and market related competence. Although there was a potential for strategic restructuring, the opportunity was lost even in the design phase. No clear vision was established and no resource synergy optimization or other changes to the organizational template were attempted. Thus there was an immediate shift to non-aligned change, rather than strategic restructuring.

The third phase was triggered by the new assessment prepared by Vehovec and his team. They had arrived at a much more critical view of the situation and estimated that urgent action was required, despite unfavorable forces in and around the company reducing the chances of its success. First of all, they regarded industry dynamics as highly negative, seeing many more threats than immediate opportunities in EU accession. They also estimated that continuing institutional pressures could play a negative role for the company. Although lacking transparent performance data, they estimated that the company's financial stability would not last more than a few years. Vehovec was also concerned about a legacy of distorted company culture, and about the very limited number of high-potential managers. This prompted defensive restructuring, with a clear focus on cost improvements and in particular the consolidation of production facilities. However, strong institutional pressures and a relatively solid short-term financial position allowed the management to avoid drastic action.

The new organizational template in late 2001 and 2002 leaned clearly towards defensive restructuring. Centralization was high, since Vehovec and his team made all the strategic decisions and most of the tactical ones. Some asset restructuring related to production consolidation took place, but without much impact on the financial situation. Most projects focused on cost improvements, from purchasing logistics and negotiations with farmers to production and distribution. All the critical resources predicted by the research model were deployed, with the addition of the technological competence the company could count on. The most delicate resources proved to be trust in the leadership, and the competent middle management. While Vehovec was not closely associated with Urbanija, he had still been part of the previous senior management team. This required him to show a clear commitment to change without at the same time reverting to an autocratic style. In addition, he was forced to deal with a significant managerial bottleneck in the company, which threatened to create a large body of opposition from disgruntled “losers”.

As noted above, in 2003 Vehovec and his team, prompted by the challenges related to EU accession and several indications of a possible hostile takeover, seemed committed to the next phase of strategic restructuring. They considered a new strategic position for the company which depended more on adding value with an excellent product portfolio, regional distribution competence, and improved brand position. They also considered a strategic partnership to protect themselves against hostile takeover and gain fast access to missing resources, gaps in which were increasingly obvious due to the companies new, numerous improvement projects. The details were still relatively vague and only the first steps, such as new product development initiatives or the brand consolidation project, had been taken in the new direction. Nevertheless, more bottom-up support for change was generated via strategic projects, which would inevitably also result in a new round of selection at the middle management level. A global perspective was assumed, accompanied by a significant amount of benchmarking and learning from other companies outside the immediate region. However, all their considerations were heavily influenced by the argument that the management would have to build the new organizational template extremely carefully if it were to retain the support of key owners. It remains to be seen whether the management will be able to succeed against major obstacles, primarily the pluralism of key stakeholder interests and limited competence in some business areas.

## **5.6 Lura**

Lura is the largest dairy company and is among the largest food companies in Croatia. In 2002 it had 235 million € of consolidated sales and around 3,000 employees. As well as its strong dairy business it is active in soft drinks, confectionery products and transportation. Lura was established in 1991, and Mr. Luka Raić holds 91% of the company shares.

### **5.6.1 Brief overview of events prior to 1993**

In 1990 Luka Raić, a young Croatian entrepreneur, used the changes in the Croatian political and economic system to expand his business. He started his first company, Ralu, bought a number of trucks and started a successful international trucking business. At the same time he sought other business opportunities, which he sensed would arise from the new privatization process in Croatia. With this in mind he established another company, Lura, and in 1993 used the profits from his trucking business, plus bank loans, to enable Lura to buy Dukat, the largest Croatian dairy. His main reasoning was that the dairy market in Croatia was tightly closed and that Dukat had practically no international competition. In addition, Dukat had not



suffered much from the collapse of former Yugoslavia or from military operations in Croatia, since its market was mostly in and around the Croatian capital, Zagreb. Raić stated his expectation of consolidating the company and improving its performance prior to major changes in the markets.

### 5.6.2 Changes from 1993 to 1998

After the acquisition Lura maintained its financial holding role and Dukat remained operationally independent, except that Raić became its general manager. Closed domestic markets, the very great fragmentation of Croatian retail in the early 1990s (not a single chain had a national presence, and the total market share of the top five retail chains was below 30%), low salaries and the low price of raw milk created a favorable cost situation for Dukat. Thus, although the company suffered from low productivity by international standards and was under the obvious pressure of market crisis due to the war in Croatia, Raić decided not to reduce the workforce. This allowed him to maintain a good relationship with the unions and improve his personal image, distancing himself from the “tycoon” label slapped on him by the Croatian media (the expression was used for individuals who used the privatization process to buy companies under favorable conditions, by which they amassed personal wealth and sometimes engaging in unscrupulous activities, often at the expense of employees and small shareholders).

Most other Croatian dairies were in a state of disarray, caused by the war, ongoing privatization and poor management. Lack of strong competition allowed Dukat to solidify its leadership position in the market and in particular its reach beyond the Zagreb area. Retail fragmentation and poor road and rail connections due to the war required significant improvements in logistics. Despite limited financial resources, Dukat also began investing in improvements in its outdated production technology.

Raić estimated that Dukat’s brand name was strong enough to be retained in the major product lines: fresh and UHT milk, yogurts and cream. In the years following its acquisition Dukat made only a few product changes, involving primarily quality improvement and more modern packaging. Although the company did a lot of advertising, it never prepared an elaborated marketing strategy and mostly used external resources for marketing activities.

As early as 1994 Lura purchased a smaller competitor from Zadar, and in 1996 it bought Sirela, the second-largest cheese producer in Croatia. It applied the same approach, which had worked well with Dukat. These firms were left to operate independently and no systematic downsizing was attempted. The brand portfolio was not optimized across the companies, and their brands were kept mostly as bought. Sales and logistics were the only areas in which potential synergies were understood early on and to some degree achieved.

Raić managed the whole group of companies using a very distinctive personal style. Although he avoided the media, he was good at internal communications, using them very persuasively to convince the employees of their company’s bright future. At the same time he made it clear that all the power was concentrated in his hands. He made all the major decisions for the companies he owned, insisting on a hierarchical chain of command.

Although it seemed from the outside that individual companies did not depart significantly from their usual way of doing business and did not create any particularly innovative strategies, entering the Lura group and having Raić as new owner-manager did generate a major change in their behavior. Not only was power removed from their previously most

influential employees, but everyone was expected to implement the decisions made at the top, and Raić insisted on thorough follow-up. No immediate dismissals for poor individual performance occurred, but fear of potential sanctions appeared and managers were tempted to please Raić by telling him what they thought he wanted to hear.

### 5.6.3 Changes in the period from 1998 to 2000

In early 1998 the market situation in Croatia started to change. Although far from dramatic, Raić sensed that the changes were indications of what the future would bring to Lura: opened markets with intense international competition, very slow or zero growth in overall consumption of dairy products, consolidation of retail and pressure for higher raw milk prices.

Because of the external changes, but also as a result of his observation that as an owner he could not be fully effective as a manager, Raić decided to consolidate the group, fully integrate all the daughter companies into Lura, and bring in professional management to take care of daily business. He hired several key managers, including a new general manager, Mr. Želimir Vukina. Vukina came from Pliva, the largest regional pharmaceutical company, where he had been Member of the Management Board in charge of sales and marketing. Of five executive directors, one (production) was promoted from within Lura, two more (distribution, marketing and sales) came from Pliva, one (HR) came from Coca Cola, and one (finance) came from INA, the national oil company. Raić remained close to the company, acting as the Chairman of the Supervisory Board.

The team's first priority was to consolidate various operational systems, including purchasing, production, sales and distribution. As a result, the workforce was decreased by more than 600, almost 25%, but only a soft approach was used, mostly early retirement and severance packages for voluntary departures. The management engaged in intensive internal communication directed at front-line employees and unions. This allowed the process to be completed without union counter-reaction, despite Croatia's very high unemployment rate and the otherwise explosive social situation.

No other priorities were pursued explicitly in that period, although the top management communicated to the rest of the company and the external audience that downsizing was not the result of company crisis but a deliberate preparation for the next growth phase, which would require the company to be better fit to function in tough market conditions.

### 5.6.4 Changes in the period from 2000 to 2002

The positive financial impact of the consolidation was visible almost immediately, and allowed Vukina to focus on another priority set by the owner: growth strategy. Several important external factors were considered, leading Raić and the management to conclude that the future of Lura was in becoming strong regional food company.

The military conflicts in the countries of former Yugoslavia were more or less over, and Lura's management estimated that these countries presented the most natural expansion target, despite their very low standards of living and purchasing power. The management favored entering these markets by acquiring local companies, believing strongly in Lura's ability to rapidly integrate the acquired companies.

The next factor, regarded as very important, was consolidation of retail. Not only did this affect Croatian retail companies, but with the improvement in the country's risk rating large

foreign chains were indicating their interest in the Croatian market. Lura's management estimated that the result of this trend would be seen within a couple of years, and would significantly reduce margins for the company. However, they also saw an opportunity in product portfolio diversification, which would allow Lura to deploy its distribution strengths, gain negotiating power with respect to the retail and use synergies in sales and logistics to drive down costs.

Along with diversification, Lura's management looked at new product development within the dairy business as a possible opportunity for rapid growth. Initial market reactions to the imported high value added products offered by competitors were extremely positive, which indicated to the management that Lura should rejuvenate its existing product portfolio, especially in yogurts, and bring some new product lines to the market. This would also include further improvements in packaging technology, estimated as important for better competitive positioning.

Changes in the political situation in Croatia, which for the first time in eight years indicated a change of government and improvement in the country's international position, were interpreted as both an opportunity and a threat. In order to enter the EU market the company had to make significant improvements in its purchasing and production processes. Despite some problems with the farmers which were beyond the direct control of the company, Lura's management decided to obtain export permits, since the improvements required would generally improve the company's competitiveness and it would sooner or later be forced to make them anyhow.

On the other hand, a local market open to international competition was seen as a significant threat. While it was approaching relatively quickly in some specialty product areas and having an impact in value added products (where high product prices could decrease the influence of import barriers), in the longer run it was predicted that Croatia would abolish all barriers for its accession to the EU. Lura's management estimated that this would lead to a decrease in sales and possibly outweigh the positive impacts of diversification.

Overall, the management concluded that the company would face a number of challenges which, although other alternatives were not completely dismissed, would be best met if Lura could find a strong strategic partner. Raić agreed, and considered selling his stake in the company and investing in some other line of business. Danone exhibited a clear interest, and discussions soon resulted in an agreement to perform due diligence.

During the negotiations with Danone Lura's top management decided to postpone the start of several important projects, such as the introduction of the new ERP system, reasoning that an agreement with Danone would significantly change the boundary conditions for these projects and lead to different decisions from those to be taken if Lura remained independent. While timing was not critical for some decisions, those concerning international expansion were seen as a priority, since the window of opportunity for acquisitions in the region was not expected to stay open for long. The delays incurred caused some friction within the management.

Towards the end of 2001 it became obvious that Lura was not making much progress with its regional expansion strategy. A small dairy was acquired in Bosnia and Herzegovina, which allowed Lura to position itself well in that market despite occasional problems with import restrictions. However, no progress was achieved in Serbia, potentially the biggest market in

the region, mainly due to political barriers which were difficult to overcome. Efforts to export Lura's products to regional and other European markets were less than successful. While here trade restrictions played a certain role, some managers blamed the failure on lack of focus, lack of people experienced in international sales and marketing, and non-allocation of the resources necessary to build brands outside of Croatian and Bosnian markets. All in all, the contribution of foreign sales to consolidated growth was below expectations.

More progress was made in non-related diversification. In 2001 Lura acquired Badel-Bap, a Croatian manufacturer of soft drinks, which had just entered bankruptcy. Along with its own line of fruit juices and carbonated drinks, Badel-Bap had the exclusive bottling license for the Croatian market from Pepsi. Raić felt that the company had been mismanaged by its previous owner and had enough synergetic potential in distribution to justify the purchase.

In parallel with the Badel-Bap decision, Raić also had to decide on the relationship with Danone. On completion of the due diligence procedure Danone prepared a concrete purchase offer, but Raić decided to reject it. Immediately thereafter, Vukina opened discussion about a possible merger with the leading regional tobacco company.

While carefully coordinating all his major decisions with Raić, Vukina maintained his top-down style. He often made the decisions on various business issues, such as the names of new products or the details of distribution tactics. He insisted on improving internal communications, but limited discussions with middle management to sessions on setting the annual plan and checking its fulfillment. As a result, the company had achieved a good record in the fast execution of straightforward tasks, but was not performing well in the area of new product development, or in business development in general.

The middle management reacted to Vukina's style with some reservations. While Vukina enjoyed owner support, he did not seem to invite the level of trust and influence Raić had from Lura's management and employees, many of whom still addressed their concerns directly to him (although he always directed them back to the top management). In private, the middle managers complained about lack of clarity in company strategy, especially when it came to regional growth. They also seemed frustrated with the delays accompanying the Danone negotiations. Although no radical decisions were made about people not performing to expectation, the middle managers also expressed more fear about the future than did front-line employees. This had a negative impact on initiative-taking and problem-solving below the top management level. Towards the end of 1991 the atmosphere was increasingly tense, with some managers looking for opportunities outside of the company.

Despite these problems, Lura kept its reputation as an excellent employer. However, the Croatian labor market remained unbalanced: even though unemployment was at a historical high, it was extremely difficult to find highly-qualified professionals, especially in the area of sales and marketing, but also in IT, finance, logistics and modern production technology. Thus, when considering promotions into middle management Lura faced a limited pool of internal and external talent. The company continued to hire very young people and began to make more concentrated efforts towards their development, and – regarding the managerial bottleneck as a potential threat to further expansion – for the first time introduced systematic managerial training.

### 5.6.5 Changes in the period from 2002 to 2003

Reconsidering the development strategy, Raić decided that a merger with the tobacco company would not be a desirable move. Vukina and one of his closest associates left, which prompted some reshuffling at the top. A Management Board was created for the first time in the company's short history. This time the only new person in top management was the new President of the Management Board, Željko Perić. He came from Pliva, where he was a Management Board member and CFO, facts indicating to observers that Raić was still dedicated to growth through acquisition. Raić officially renounced any intention of selling the company in the near future, vigorously reinstating his aim to make Lura a regional food company and announcing that the first acquisition targets would be various food businesses within Croatia. Lura was to continue its international expansion after solidifying its position at home.

Soon after the changes at the top, Lura entered a new line of business through the acquisition of Sloboda, the second-largest confectionery company in Croatia. Lura used its experience from previous acquisitions and its strong distribution network in Croatia and Bosnia and Herzegovina to boost Sloboda's sales, while gradually consolidating it and reducing its operational costs.

According to the new strategy Lura was split into divisions along four main lines of business. Efforts continued to fully consolidate them and utilize all potential synergies, especially in the areas of marketing and distribution. A breakthrough was achieved in new product launches, which more than doubled in comparison with the previous period. This was accompanied by significant investments in brands, but also in new design, production and packaging technologies. At the same time, the product portfolio was pruned to better utilize the available resources. Distribution flexibility and the ability to adjust to local tastes were seen as key competitive advantages over similar products from multinational companies.

Pressure on costs from retail consolidation, EU-subsidized dairy product exports (especially cheese) and a major increase in raw milk prices (up to EU levels) prompted continuous internal efforts to decrease the number of employees and improve productivity, which still lagged behind all of the best-performing regional competitors from Austria, the Czech Republic and Slovenia. However, Lura continued to take only a soft approach to downsizing, not willing to jeopardize its excellent relations with the unions and front-line employees.

As a part of the effort to improve its cost position Lura made significant investments in new IT systems, including handheld terminals for sales people, which facilitated much better control over receivables. Two global consulting companies worked in parallel on process and logistics improvements.

Lura continued to gradually expand its sales in the region, but the management reopened discussion about target geography for its expansion. Although Serbia was still seen as a potentially interesting market, Perić admitted that Lura should not bet its expansion on the uncertain prospects of acquiring a good local company and through it a market position in Serbia. Lura turned to examining possibilities in other countries of South East Europe and their surroundings. A public statement was made about the interest in acquiring Ljubljanske mlekarne, the largest dairy in Slovenia (see 5.5). To secure financial strength for the company and facing increasing levels of short-term debt, Perić started discussions with the European Bank for Reconstruction and Development. EBRD was identified not only as a possible

source of long-term financing, but also as a credible financial partner which could prepare the company for an eventual initial public offering on an international stock exchange, the process Perić had undergone with Pliva.

While instrumental in forcing out Vukina and reshaping the top management team, Raić stayed within the limits of his new role as Chairman of the Supervisory Board. He limited his involvement to occasional discussions with Perić on the company's key strategic objectives, consistently refusing to mix in daily matters or make decisions which would undermine the authority of the company management.

In contrast to Vukina, Perić immediately announced his full commitment to teamwork and the substantial involvement of middle management. All the decisions of the Management Board were based on consensus among its members. This required better preparation for meetings, but did not significantly slow the company down. During the Management Board's first year, only one decision was delayed because of lack of consensus. Perić decided not to chair all the meetings, but asked the respective member whose area of responsibility was the meeting's focus to do so.

Immediately after the first Management Board meeting Perić commenced the reevaluation of strategy. He first engaged just the members of the top management team, but after establishing a broad framework expanded the group to twenty people. After a while the Management Board reviewed progress and, finding it satisfactory, involved thirty people in the next level of refinement. After nearly a year of work on the new strategy, a final two-day workshop was organized for seventy participants. Perić used it to set a highly interactive tone, which allowed many previously undiscussed issues to surface, as well as facilitating better understanding for all present of the company's true potential and the critical issues to be resolved.

Something else which Perić initiated early on was the holding of one-on-one conversations with thirty key company people. He found this necessary to restore morale and to prevent potential defections, but also to personally assess the competence of these people and their readiness to accept new business targets and styles of work. He also introduced individual performance targets as a basis for determining the annual bonus of members of the middle and top management teams. All were given a full insight into the performance criteria by which they were being evaluated, and the results they were achieving. Based on the conversations and more strict performance monitoring, he decided to replace several middle managers. Most of those replaced were offered other positions within the company, since Perić felt that layoffs should be made only in extreme cases.

Perić made it clear that he expected honesty and ambition to be core values within the team. He used the consulting projects, as well as internal improvement projects started by the top management, to convince his managers that the company had not yet attained the required level of performance. To reinforce the message and facilitate learning from the best international practices, and to bypass the constraints of the local labor market, Lura hired an experienced Austrian production manager and committed himself to further such steps. Ensuring good matches with the target culture became an important part of the selection process in all new hiring. At the same time more emphasis was placed on education, in particular for middle management.

Despite a clear drive from the top towards building a new company culture, some middle managers still lacked initiative and the readiness to adapt to new circumstances. Age seemed to make a difference, with younger managers displaying a more proactive attitude. However, the company also identified growing problems with the attitude of fresh graduates, who while entering their first job with very limited knowledge at the same time felt that they “deserved a lot”. Fear of job loss was present among both middle managers and front-line employees, despite soft approaches to personnel issues and the very high level of employee legal protection, which prevented disciplinary action even in clear cases of abuse.

#### 5.6.6 Summary of research findings from the Lura case

Four distinct periods can be observed in the history of Lura, if one disregards the inactive period at the very beginning while Raić waited for the right acquisition opportunity to arise. From the acquisition of Dukat to mid-1998 the company did not change its strategy or the basic elements of its organizational template. No true restructuring of the acquired companies was attempted. The production orientation of the companies inherited from the previous period was left to dominate, although some improvements in production and distribution were made.

Several factors appear to have influenced Raić in assessing the situation and the need for change. First among these was the nature of the privatization process in Croatia, which created a window of opportunity for entrepreneurs like Raić to acquire companies under relatively favorable conditions. The process favored those in good standing with the political elite, as well as those who obtained considerable assets early, since they could use them to secure more loans to acquire yet more assets. However, since no fresh capital was injected into the company, the process typically created cash-flow pressures.

Secondly, the war in Croatia actually worked in Lura’s favor. High risk deterred multinational competitors from entering Croatia on a larger scale. Problems caused by the war, in particular the low liquidity of retail and the need to import raw milk, had a very negative impact on small local competitors. Logistical problems caused by the war required excellent logistical capabilities, exactly the area where Raić possessed an advantage due to his extensive experience in the trucking business. All of this created a situation in which conflicting forces were at work: while the market situation was in principle unfavorable, Lura seemed to be in a less difficult position than its competitors. At the same time institutional pressures discouraged change, even were it perceived as necessary. First came direct media pressure on “tycoons”, generating strong public sentiment against the kind of behavior Raić realized he must avoid, even though it might have business merit and justification. Secondly, there was general pressure against downsizing, given the high employment and huge social problems caused by the war.

Another factor influencing the assessment of the need for change and its viability was Lura’s financial situation. Any investment in restructuring would decrease the funds available for opportunistic acquisitions, which were, given the limited duration of the window of opportunity, obviously of highest priority. On the other hand, due to its relatively strong market position Lura’s financial situation was not critical, and did not require immediate responses to improve it.

Finally, Raić, while gathering managerial experience, was still acting more as an entrepreneur than a manager. He lacked a larger team of trusted associates and preferred to minimize his

risks by controlling operational issues directly. This limited his capacity for dealing with strategic issues apart from the acquisition process.

All the evidence indicates that Raić altered his assessment of risks and opportunities in 1998. The trigger was the assessment that the company's financial situation would deteriorate due to changes in industry dynamics, primarily accompanying the entry of global competitors and retail consolidation. Institutional pressures did not halt the change, but influenced the speed and mode of its execution. Sufficient financial resources acted positively once the decision was made that change was needed. Raić also could count on his position as a trusted leader, which he had built up during the first period.

The nature of change was clearly defensive, since the company focused on decreasing costs and in particular on downsizing. Despite change at the top, decision-making was still highly centralized and top-down. More attention was paid to the ability of the company to track its performance. Communication with labor unions and employees (including middle management) was intensified, but focused on the need for change as well as on operational planning.

This defensive reaction met very little opposition and even that only in passive form. What there was came mostly from middle managers, who feared for their positions. But a relatively poor organizational setting and a low level of skills slowed down the change and prevented the company from making all the cost improvements possible.

The trigger for the next phase came less from the assessment of the need for strategic restructuring than from the assessment of its feasibility. Raić had relatively clearly defined ideas about expansion, but only when management resources had been built up and the looming financial crisis resolved could the company focus on pursuing new strategic opportunities.

However, while the trigger for strategic restructuring was obviously influenced by the assessment of industry dynamics and the availability of resources, after a very brief initial period restructuring became blurred and the pattern of change began to resemble weakly aligned change, which gradually degraded to non-aligned change. Strategy swerved from regional diversification to strategic partnership, without clarity of reasoning and without a convincing plan of action. Trust in Vukina as a leader was lost (or better said, on the employee side never fully developed) in the process. He never established bottom-up commitment to change. Lura's management also reversed its optimistic view regarding the success of strategic restructuring, and practically blocked the change by concluding that it would be impossible without a strategic partner.

The trigger for the final cycle of change was clearly the disappointing takeover offer made by Danone. It convinced Raić that strategic partnership might not be a feasible strategy after all, and caused him to reattempt strategic restructuring. This time all the missing elements were deployed: more focused vision, use of consultants, foreign managers and global benchmarking as sources of learning and drivers of a new culture, reorganization into business units and heavy use of IT for performance optimization and monitoring, focus on customer intimacy, new product development and marketing as strategic differentiating factors, a continuous focus on process improvement in aid of a better cost position. The commitment of middle management was secured through project work and joint strategy development, but also through the direct communication initiated by Perić. However, pressure



on performance was increased, the only major leadership intervention not forecast by the research model.

Resistance to change came primarily from middle managers who felt threatened and ill-equipped for adjustments. Lack of appropriate skills and knowledge, as well as problems in securing an inflow of managerial talent, can be identified as further major barriers to change. Some change fatigue became obvious and was intensified by the lack of change leaders at the middle level, which put great pressure on the small group of existing leaders, stretching them thin over a number of change initiatives and potentially decreasing the positive effects of the otherwise high level of organizational learning during the last phase of change.

## **5.7 Podravka**

The Croatian company Podravka is among the largest food processing companies in Central Europe, with 350 million € of revenues and 6,500 employees in 2002.

### **5.7.1 Brief overview of company history prior to 1991**

The company was founded in 1934 as a fruit-processing plant in the small town of Koprivnica, the centre of a Croatian rural area. After two decades of slow growth, interrupted by the war, the company used the period of state-led industrialization in former Yugoslavia to build new plants and significantly diversify its product portfolio. In the mid-1950s it introduced some of its “evergreen” products (such as traditional chicken and beef soups), which for decades provided an extremely important source of revenue. Finally, in 1959 the company struck gold: it launched “Vegeta”, a universal food seasoning that became an instant hit in Yugoslavia and soon became extremely popular across Central and Eastern Europe.

The closed markets of former Yugoslavia, as well as those of the former Soviet bloc, did not require much sales and marketing effort. High-quality products were rare and would literally sell themselves, and strong brands were established by word of mouth. While the distribution network had to be built in Yugoslavia (this carried out extensively through the 1960s), Podravka did not have to worry about distribution within the Soviet bloc countries. It was enough to get goods on the barter list, and then state importers in those countries did the rest.

Podravka used its opportunities well and by the end of the 1980s had grown to more than 10,000 employees. It followed regional practice and developed a wide business portfolio. On one side, it integrated backwards and owned farms and meat business that operated as internal sources of raw material and sold their products in the markets of former Yugoslavia. On another, the company built up a number of different food processing businesses, some of which were modestly active in international markets. The exception was Vegeta, which was already present in some 30 countries, although it had a clear brand position primarily in the countries of Central and Eastern Europe. Podravka also used its financial strength, strong manufacturing experience and good political connections to start a small cosmetics division, which soon diversified further into pharmaceuticals, both selling almost exclusively in former Yugoslavia. Finally, in line with the dominant socialist philosophy, the company provided a number of infrastructure components, from security, catering, health and recreation services for its employees to a local hotel and a printing house.

Asked about the most important legacy of the period prior to 1991, most of Podravka’s managers agreed that it consisted of both valuable assets and a few liabilities:

- Vegeta, one of the strongest brands in all of Central and Eastern Europe;

- Other excellent brands, e.g. soups, in former Yugoslavia;
- Extensive, although somewhat outdated, manufacturing capacities;
- (Too many) highly loyal employees;
- Excellent relationships with the local community and the business and political elite in Croatia.

### 5.7.2 Changes in the period from 1991 to 1995

With the commencement of hostilities in former Yugoslavia the situation for Podravka deteriorated fast. Not only did the company for political reasons lose the markets of Serbia and Montenegro, but due to war in Croatia and Bosnia and Herzegovina the demand in those countries declined to a fraction of pre-war levels and logistics suffered greatly. Furthermore, the company was requested to produce food for the Croatian army at extremely low prices, while payment was delayed for years.

Sales in Central and Eastern Europe also suffered, partly because of the huge economic downturn in the region, but also due to the increased competition of Western food companies which were making inroads into the region's markets. New, heavily-advertised brands appeared at a frenetic pace, putting Podravka's pricing strategies under pressure and eroding its market shares. Distribution and retail in the region were also changing in structure, the old state wholesale companies losing importance against international retail chains and local start-ups.

Podravka was slow to recognize the new situation. Since the company was practically nationalized in 1991, its newly-established Supervisory Board featured mostly government representatives, including a few army generals, who lacked any business background but were eager to get involved in daily decision-making. The top management succumbed to pressure and refrained from making any major decisions without the full agreement of Supervisory Board members, which meant that practically no significant strategic decisions were made. At the same time, social crisis, the lack of transparency in controlling and poor internal discipline led to a surge in improper practices, from the acceptance of bribes in making purchasing decisions to outright theft from production and finished goods warehouses.

The relative passivity of Podravka's top management was utilized by some of the more entrepreneurial sales managers to make more systematic sales efforts in Central Europe. However, due to lack of financial and human resources, they mostly worked by exporting through new local distributors. Because of the deteriorating financial situation only very minor investments were made in new product development and brand support in foreign markets. Although financial performance was suffering, the top management was primarily concerned with maintaining maximum employment and social stability in the local community, which was under great pressure due to the war. Obvious gaps in competence between Podravka and its growing competition in regional markets received little attention from the top, although they created frustration among more agile middle managers.

After the start of the privatization process in Croatia, Podravka's management used every opportunity to advocate keeping the company conglomerate together. At the same time they clearly preferred the state to have a significant say in its possible break-up and piece-meal, government-orchestrated privatization. However, some external observers and many employees felt that a few executive team members were discretely hoping for the further downfall of the company, which would render their purchase of parts of it affordable.

In early 1996 it became obvious that Podravka would, despite the end of the war in Croatia, go bankrupt unless some urgent measures were taken. The government, having huge problems with its massive post-war budget deficit, was reluctant to invest in strengthening its balance sheet. Instead, the European Bank for Reconstruction and Development (EBRD) was asked to take an equity position in the company. After basic due diligence procedures, EBRD agreed on condition that the company start restructuring immediately under the guidance of a leading international management consulting company. Also, a seasoned international consultant was put in the role of personal advisor to the CEO, spending two weeks a month “shadowing” him and acting as the bridge between the consulting team and the top management.

### 5.7.3 Changes in the period from 1996 to 1997

After taking a first snapshot of the situation and the company’s activities, the consultants initiated a number of projects, some aimed at a rapid improvement in performance and others pursuing more substantial restructuring. All projects were staffed by mixed teams involving foreign consultants and over 100 middle managers and technical experts from the company. Most of the employees involved in the projects demonstrated considerable willingness to learn, and a solid dose of enthusiasm. Almost all felt that the projects were a much-needed opportunity to start changes after a frustratingly long lack of response to mounting problems.

The consultants made it very clear that the company had too many employees and many small businesses that had nothing to do with food or pharmaceuticals. Some of the latter were subsequently spun off; the same went for some of the food-related businesses, e. g. farming and spirits production, which suffered from poor performance and were, in the opinion of the consultants, either unlikely to be highly profitable in the future or did not represent part of the true core food business. At the same time, the company offered early retirement as well as relatively generous (at least by local standards) outplacement packages to part of its workforce, gradually reducing the number of employees to 6,500. The vast majority of reductions were among production personnel.

In facing the crisis the company completely centralized decision-making and reinforced its top-down culture, which had been somewhat diluted since 1993. These measures were accompanied by a tightening in the amount of information passed from the top. Plans were not discussed across the different levels of the hierarchy, and the middle management was often surprised by the way top management interpreted the suggestions of the project teams. Members of the top management engaged in frequent power battles, which increased the atmosphere of secrecy surrounding their decisions and actions.

One of the decisions made early on based on suggestions from the consultants was to establish a more transparent planning and control system, which was supposed to finally allow the management a clearer understanding of which product lines were money-makers and which losers. This proved to be more than a mere technical exercise, generating plenty of heated discussions about the role of overheads and their contribution to the business results of individual segments within the company. As an almost natural consequence, the debate spilled over into the organizational design area. Some managers believed that Podravka should have been split into at least two parts: a core food business with satellite non-core food companies (e. g. meat or beverages), and the pharmaceutical business (Belupo). Their main arguments included the lack of synergy between the businesses, the poor efficiency of corporate services, and the danger that subsidizing poor performers would kill off potentially successful units.

Others claimed the company should remain tightly integrated. They pointed out the benefits of centralization in a crisis period, and claimed that performance monitoring was a matter of political will and had little to do with organizational structure. They also warned that some of the supporters of disintegration were actually those hoping to split the company into pieces and then glean huge personal benefits from privatization of the part over which they had particular influence. In the end, two divisions were created and placed under the direct control of two Management Board members. Both of the latter were undisputedly industry experts, but they polarized rather than unified their subordinates and often found themselves involved in controversial situations.

Another area of dispute provoked by the restructuring projects was the definition of core businesses within food. The consultants took a fairly conservative approach, based on their understanding of the company's core competences. In their opinion, the company needed to focus on branded goods in small packaging with a long shelf-life and high added value per unit. Strict application of this definition would give the company a significant focus and require the divestment of beverages, meat, and the processed food and vegetables businesses. Although the top management never publicly rejected this advice, it initiated several projects to investigate whether these businesses could become feasible despite the large losses which all of them generated in 1996 and 1997. Some of these projects were prepared under the auspices of a newly-created management development program, aimed at the top 200 managers as well as some high-potential young employees.

By 1997 the Supervisory Board had come under pressure from the EBRD to support more energetic changes. As a result, it finally arranged for a change at the top. Zvonko Majdančič, CEO since 1990, became a member of the Supervisory Board. He was succeeded by Ante Babić, one of the most experienced people at headquarters and widely admired for his personal integrity and commitment to the company. Most other senior managers remained in their positions, while more changes were almost immediately made at the middle management level.

#### 5.7.4 Changes in the period from 1998 to 1999

Noting that major downsizing and other cost cutting measures had improved the financial situation of the company, Babić decided it was time to focus on the next steps of restructuring, and in particular on strengthening Podravka's market position. Podravka also launched investment projects totalling almost 200 million €, building several new factories in Koprivnica, Hungary and Poland. This was in disregard of the market situation: in a few worst cases, plants were running at less than 40% of capacity. In many cases tensions were triggered among production, R&D, marketing and sales, these functions blaming each other for poor performance.

Significant attention was paid to the reorganization and strengthening of domestic and foreign sales and the distribution network, which gradually took over as the most powerful internal entity, a position once held by production. Podravka's managers felt that improvement of operational sales had contributed significantly to the growth in revenues seen in 1997 and 1998. However, the company still lacked a detailed marketing strategy, and in many cases local sales executives reported that Podravka's products were not cost-competitive. When investigating the problem the management discovered that production costs still exceeded the industry average, but also that the quality of goods was above the average.

More advanced customers saw the company's packaging as somewhat outdated, and pushed Podravka for changes. Consumer surveys conducted in Croatia did not support this need: most consumers felt comfortable with the packaging and especially with the traditional design Podravka had used for its core products since the day they were launched. Surveys in other countries produced less clear results and the management started to seriously consider whether changes were required. A final decision was held up by strong disagreements about branding: should the "Vegeta" brand be extended to other products (such as soups) and, if so, which ones?; should "Podravka" be used as an umbrella brand?; and should the brand strategy be homogeneous across all countries or adjusted to reflect current realities?

Despite the fact that it had two strong regional brands, Podravka did not have much experience in branding. The newly-formed strategic marketing department was preparing to introduce the posts of brand and product managers, but most insiders felt that the move simply reflected a desire to match commonly-accepted practices in the industry rather than to create a competence within the company.

Babić initiated a heated debate about the efficiency of Podravka's R&D. The company had not launched any new products for quite some time, but was introducing many new varieties of existing products, some with more, some with less market success. The R&D people felt that they had not been treated fairly in these discussions. Given the mature nature of the industry, they cautioned against hopes of developing a new product which would repeat the success of Vegeta.

In an attempt to more accurately monitor the company's performance and the benefits of the many projects introduced since the start of change, Podravka decided to completely refurbish its management information system. However, implementation was not as rapid as expected. Most managers agreed that controlling had become more formal at the tactical level, but that it simply reinforced the internal focus, did not deal with the crucial issues (including wrongdoing) and did not link rewards to strategic performance issues.

While some operational improvements were obvious, disagreements among top management and power struggles continued. Babić was very concerned about the company's long-term viability. He tried to push for faster changes but avoided direct confrontation with colleagues from the Management Board. He strongly supported the management development program started under Majdančić, hoping that it would increase the pool of high-performing middle managers. He felt that the company needed more of these, both to increase initiative-taking below Management Board level and as a possible pool of replacements for those members of the top management team with whom he did not feel comfortable.

Babić felt under constant pressure from the Supervisory Board, which still used its political clout to keep the top management under full control and promote the interests of the local community and the country's political elite. In order not to stir up too much disagreement with members of the Supervisory Board, whom he felt were not supportive of more aggressive change, he tried to change existing practices only gradually. In this context, many senior and middle managers complained about a lack of clear vision and strategic direction from the top.

Attitude surveys conducted in the company indicated clearly that Podravka had very loyal employees. However, the surveys also showed that loyalty was based on an image of Podravka as a successful company, offering social security to its employees and satisfying the

various needs of the local community, i.e. the image of what Podravka used to be. The employees focused on the well-being of Koprivnica and cared less about what was happening elsewhere. Job security was the key motivating factor for the great majority of employees. In addition, the level of readiness to travel, take initiative and assume personal risk was very low, except for the youngest group of employees (below 30 years of age).

In his efforts to speed up change, Babić approached a Western European food company somewhat larger than Podravka which seemed to be a good candidate for a possible merger. Discrete talks started in 1998 but the Supervisory Board did not show much interest in pushing for any faster results and no progress was reported after 2001.

The 1999 business results were particularly disappointing. Despite the somewhat improved general situation in all export markets, some of which had began to recover from the 1998 Russian crisis, Podravka consistently performed below expectations in almost all product categories and key markets. The situation was particularly bad in Poland, Russia and Croatia. The management mostly blamed external factors, such as the liquidity problems of most retail chains in Croatia, for these poor results. However, some industry observers believed that poor performance was the result of the company's defensive management style, and the lack of a coherent and aggressive sales strategy in the domestic market which would fully utilize the company's sales and distribution strengths.

Financial analysts warned of the potentially big financial problems the company faced over a two-year period unless it recovered fast and resumed high growth. This news reduced the value of shares to a record low and prompted Babić to consider other options. His health deteriorated and, in February 2000, he decided to retire.

During the short period under Babić it became obvious that the restructuring projects started by the consulting company had run out of steam. More and more of the employees who had participated in those projects were openly frustrated by the way the top management had interpreted their results, which they felt simply preserved the status quo. Although Babić claimed that Podravka was decentralizing, most middle managers disagreed and felt that they still lacked influence. At the same time, a significant portion of the employees refused to take initiative and regarded the past fondly. These people were worried about the prospect of further change, fearing that the company would lose touch with the local community and would disregard what they felt were its social obligations.

#### 5.7.5 Changes in the period from 1999 to 2003

Just before Babić retired, the Supervisory Board finally decided to deal with indications of wrongdoing at the top and commenced a major shake-up of the Management Board. Several people were asked to leave the company; three new members were appointed from the middle management ranks. The new CEO, Darko Marinac, supported these appointments and added his own external choice of CFO. Marinac had 25 years of experience in the pharmaceutical industry, and prior to coming to Podravka had been responsible for the international expansion of Pliva, the largest Central European pharmaceutical company.

Marinac decided that his first priorities would be to establish good communications within the Management Board and to identify the key issues facing the company. He was told by the Supervisory Board to produce rapid financial recovery. In his own mind the only way to do this was to increase revenues, since further cost-cutting would completely destroy the already poor morale of the employees. Not from the region, he was met with suspicion by some

members of the local establishment. They feared Marinac would try to cut the strong ties the company had with the local community and move many activities out of Koprivnica, thereby reducing the employment opportunities on which the town critically depended. The prospect of selling Podravka to a multinational company was also a highly delicate issue, since many believed it would lead to drastic cuts in employment.

Marinac and his team reviewed the advice which Podravka had received from the consultants, but found it too focused on short-term issues, primarily aimed at downsizing and cost-cutting. The new Management Board members also confirmed that the middle management felt disempowered and had not bought into previous decisions from the top.

Marinac had to make a difficult choice between starting the new vision process from the bottom up – which could lead to much wasted time and effort without some prior direction from the top – or risking the strategy being rejected again as being forced on people. He decided to devote some time to discussion within the Management Board before approaching the middle management with a proposal for a broad vision for Podravka and asking for their feedback. Only then would the first two layers of management engage in defining a medium-term strategy for the company.

The discussions within the Management Board proved to be more demanding than expected, and took up a good part of Marinac's first year. Even within his team, there was some reluctance to push ahead due to the possible consequences of change for the local environment. Finally, the Board came out with a clear statement on one of the most sensitive issues: Podravka's core business. They intentionally kept the definition broad, including both food and pharmaceuticals and focusing on all the business lines with the potential to be leaders in their core markets. This in practical terms implied that some of the less successful businesses, like meat, would stay in the company only if they could regain a leading position in the Croatian market, which seemed a reasonable target. Overall, Podravka confirmed its ambition to be the largest food company domiciled in Central and Eastern Europe.

In accordance with this statement, Podravka was reorganized into ten business units. At the same time, several new corporate services were introduced, with the business development department being the most important. The introduction of SAP was finalized, fully integrating company IT support. Podravka then carried out a major benchmarking exercise, comparing itself with the best Croatian companies and then with 14 successful international food companies of similar size to Podravka. The key purpose of this exercise was give managers a picture of true company reality, and to challenge them to start thinking "outside of the box", without being obsessed with a "Podravka way" of doing things.

Once consensus was reached on these issues, the Management Board began a strong communications campaign within the company. It also engaged all the business unit managers, people from the business development department and, ultimately, a broader group of line managers, in a series of workshops which had the goal of producing detailed three-year strategic plans for the company.

Through the discussions it became obvious that Podravka should not try to achieve the position of a global innovator, but be content with the role of a follower. Yet the management felt that the company should build a premium position in the markets it covered, based on the notion of traditional, high-quality food it stood for under the slogan "the joy of eating". Heavy advertising support should be used to support this brand image for both Vegeta and Podravka.

It was felt that having strong brands should allow the company to more systematically explore opportunities for brand extension in existing markets. More focus was placed on new product development, producing good results in a relatively short period of time. In addition, Podravka's management felt that the company should explore the possibility of entering new markets in order to achieve higher sales volumes for its mature products.

In order to reach its ambitious growth targets of 10% annual growth in revenues and 15% growth of EBIT, Podravka decided not just to depend on organic growth, but to undertake more intensive M&A activities in the region. With a strong record in this field from his days at Pliva, Marinac felt comfortable in leading these activities personally. As a result, in 2002 Podravka acquired Lagris, the largest independent food company in the Czech Republic, as well as a number of smaller companies in other countries, in particular in South East Europe. These acquisitions also allowed Podravka to prepare for 2004, when most Central European countries which were the company's core markets would join the European Union. It was expected that additional barriers would be created to Croatian exports and that the company's cost position would come under further pressure. Thus, access to cheaper labor and raw material was secured, plus additional production capacity within the enlarged EU.

Along with M&A activities, Podravka decided to pursue strategic partnerships in the distribution area. Among other things it took over distribution of Unilever ice cream in Croatia, Heinz products in Hungary and, in a potentially significant agreement, Nestlé products in all the countries of former Yugoslavia except Slovenia.

While its focus remained clearly on South East and Central Europe, Podravka intensified its activities in both east and west. It actively reviewed its strategies in Russia, including the possibility of acquiring some of the companies that already had a strong presence in that market. It also tried to forge alliances allowing it to use its free production capacities to manufacture under license for Western European partners, for their needs in Western European markets.

Finally, Podravka's pharmaceutical division was floated on the local stock exchange in 2002, as a sign that Podravka was ready to consider optimizing its position in the pharmaceutical business. By early 2003 the company was enjoying strong growth in all businesses and had achieved results above the plan's expectations.

Marinac spent a considerable amount of time on people-related issues. He pushed for more internal communications and middle manager initiative-taking. He gave special attention to building a highly professional HR service within the company. One of its priorities was to help the Management Board assess the potential of the top 50 people in the company, as well as the top 25 people in the talent pool. Several BU managers were replaced within one or two years, the period Marinac felt sufficient to clearly reveal true performance levels. Benchmarking and strategic alliances were seen as great learning opportunities (Nestlé, for example, agreed to provide access to its executive education program as part of the distribution partnership), and the company hoped to gain some additional talent through its acquisitions. Lack of managerial talent was seen by top management as one of the key factors limiting faster growth, the other being the slowness of the change to a true culture of international orientation and entrepreneurship. Some senior managers also indicated problems stemming from an insufficient level of professional know-how, especially in marketing and



new product development, under-functioning cost management, and some lack of cohesion in top management, which caused relatively slow decision-making.

#### 5.7.6 Summary of research findings from the Podravka case

Four cycles of change can be observed in Podravka in the period from 1991 to 2003. The first was the period to 1996, during which there was no change or some occasional non-aligned change (privatization, the commencement of non-systematic sales expansion in Central and Eastern Europe). Institutional pressures and lack of trustworthy leadership seem to be the most important factors influencing the apparent lack of trigger, which accords well with the research model. The purpose of the company was perceived similarly by all key stakeholders (management, employees, the local community and the state as key owner): to provide jobs and act as a source of funding for the needs of the local community, rather than to secure profits or the long-term strategic sustainability of the company. A lack of performance transparency was obvious, although in the case of Podravka it is not very clear to what degree poor control systems significantly caused the trigger delay. However, once it became evident that the company was not financially viable, its owners moved and the second cycle was initiated. Again it is interesting to note that owners, not managers, provided the trigger. This can be easily explained by the balance of power within the company, where management did not act overtly but rather through political lobbying, leaving the front of the stage to the Supervisory Board and its political heavyweights.

The pattern of events before and during the second change cycle seems to be fairly typical. Its late response to sweeping changes in the environment not only brought the company to the brink of financial disaster, but also created all the typical behavior patterns of “losers”, including frustration, a mixture of denial and helplessness, the blaming of others, and unethical behavior. These added to the factors influencing the assessment of the need and possibility of change, which eventually brought in EBRD as the change catalyst.

With no powerful internal change agents, consultants were brought in as external change agents. Under the direct pressure of the owners defensive restructuring was started. Here all the elements of the new organizational template predicted by the research model were present. Asset restructuring seemed to be more effective than expected, but that was due to the fact that in Podravka’s case it represented a method to decrease employment rather than to benefit financially from asset disposal. It is interesting to note that the research model’s suggestion of a focus on a local rather than a global perspective is confirmed here despite a global consulting company being the change agent. Almost all the advice which the consultants offered on the basis of their global perspective was met with suspicion. Virtually all the sources confirm that anything not conforming to local habits, “the way things are done”, was treated as going against the interests of the local community, regardless of whether this was true or not. This generated significant resistance and halted designed changes the moment the consultants passed them to the management for execution.

Looking at the resources needed for successful implementation and the expected leadership interventions, it becomes obvious why the change (downsizing and some cost-cutting) was only partially successful, and why it created a lot of frustration. Active leadership from the top of the organization was missing, as was trust from the middle managers and front-line employees. Communication was extremely limited, allowing the circulation of rumors and producing more resistance to change. Boosted by fear at all levels of management and institutional pressures from the local community, change was stalled.

The trigger for the next two change cycles was the same: the company's poor financial performance and the owners' assessment that change was necessary and possible under new leadership. In the third cycle of change, this resembled more non-aligned change than either defensive or strategic restructuring. Although initially triggered by the owners, it seems that the assessment of the need for change suffered from diverging interests within the top management group. While Babić wanted it, the rest opposed it, and he did not exercise enough power to create change. He did not offer a clear vision, which kept the middle management confused and lost him their trust (which he had initially held because of his reputation). He also did not make the necessary changes in terms of business focus and transparency of performance. Particularly troublesome was the way the company expended its scarce financial resources on upgrading its manufacturing capacity. While some of this seemed justified (new pharmaceutical production facilitating higher value) some seemed unaligned with either the cost or value position of the company. Thus Babić's attempts to achieve strategic change were not consistent enough and left too many blank spaces.

In contrast to Babić, Marinac created a new organizational template, one which comes close to the research model's predictions on strategic restructuring. He made the target strategic position of the company clear: added value based on high quality, local taste, strong brand and excellent distribution. He reorganized the company along business lines and introduced the necessary infrastructure support units. The company also took on a global perspective (through the benchmarking exercise and by learning from its strategic alliances).

Of the key resources predicted by the research model, several deserve more comment. Financial slack definitely influenced the speed of change. Podravka had little available, as a result of the late start and slow progress of the initial stages, as well as its poorly-aligned use of resources in the past. The company was burdened with debt, so it had to improve its operational performance before it could allow itself major new investment in critical areas. This is another reason why the time available for changes becomes highly important. Marinac had to manage the expectations of the Supervisory Board to gain that time.

Trust is another of the resources predicted by the research model. Marinac was in an interesting situation regarding trust. On the one hand, as an outsider with an excellent professional reputation he could hope for the initial level of trust needed to start the change. However, given the extremely closed nature of the local environment and the high level of perceived threat he presented to it, he had to make some initial compromises, accept the position of the local community as legitimate, and earn its trust by improving company performance without taking measures damaging to local interests. This balancing act proved to be time-consuming and potentially damaging in the short term, but Marinac explicitly acknowledged the need for it and seems to have been successful in performing it without stalling the change. To a large degree this is because he managed to establish a dialogue with the middle management, as predicted by the research model. The time available for the change again appeared to be critical, plus the overall consistency of change design and implementation.

Finally, it is interesting to see how much attention Marinac paid to the issue of optimal use of human talent. As opposed to Babić, who fully supported the management development program but made very few interventions in selecting the talent pool, Marinac paid less attention to education (it was almost assumed that individuals would take care of it and much would come from learning by doing), but was much more active in managing the talent pool,

sending clear signals on expected performance and the consequences of both positive and negative results.

While in Babić's case strategic uncertainty appeared to be a barrier to change, this was not at all obvious in the case of Marinac. One logical interpretation may be that the objective high level of uncertainty plays a more important role in the absence of vision. Other barriers, in particular the various forms of fear, poor structures and (especially) lack of skills and knowledge, were all easily observable.

Finally, it is possible to see that very little organizational learning occurred in the first two phases. Even though some good business practices were occasionally introduced, poor communications prevented them from being widely accepted. The same applies to the management development program. More than 150 managers attended it, but their selection seemed to be random and often politically influenced. The application of learning from the program was sporadic and not systematically required or supported by the top management. Also, the high level of frustration with the slow pace of change and the high personal risk involved (especially on middle management level) decreased willingness to fully engage in spreading the benefits of the program. In the last phase learning appears to be slightly more extensive, although there are indications that the level of teamwork and initiative-taking necessary for organizational learning are still not at the desired level.

## 6. Cross-case analysis and integration of research findings

The purpose of the following text is to build on the individual case analyses presented in the previous part of this dissertation. To do so, research findings from individual cases will be compared for their similarities and differences. The research model will be used as a framework for this comparison, and the main research question presented on page 84, plus the detailed research questions presented on page 90, will be answered based on the conclusions from the cases. The answers given will then provide the starting point for a discussion of the consequences of the field study for the research model and its refinement.

### 6.1 General characteristics of the strategic changes observed

All seven cases indicate a substantial amount of change in the observed companies, as well as several distinctive periods (cycles) of change for each of them (Table 6.1). The nature and the sequence of individual change cycles will be discussed in more detail later. One company underwent only two different change cycles, one underwent three, and the remaining five companies four change cycles each. At this point it is interesting to note that out of 25 cycles, only six had somewhat blurred features and were therefore characterized as non-aligned changes, while in two cases companies did not react to initial changes in the environment in 1991. Of the remaining 17 cycles, seven were characterized as defensive restructuring and ten as strategic restructuring. In two cases the last cycle has been initiated, but the company is still in the design phase and the new organizational template is not yet completely clear.

| Case                    | Period 1    | Period 2    | Period 3    | Period 4                 |
|-------------------------|-------------|-------------|-------------|--------------------------|
| Gorenje                 | Defensive   | Strategic   | Strategic   | Strategic <sup>120</sup> |
| Kolinska                | Defensive   | Non-aligned |             |                          |
| Končar                  | Defensive   | Non-aligned | Strategic   |                          |
| Lek                     | Defensive   | Strategic   | Non-aligned | Strategic                |
| Ljubljanske<br>mlekarne | Non-aligned | Non-aligned | Defensive   | Strategic <sup>1</sup>   |
| Lura                    | No change   | Defensive   | Strategic   | Strategic                |
| Podravka                | No change   | Defensive   | Non-aligned | Strategic                |

Table 6.1 Nature of change in seven observed cases

Only Kolinska kept the same general manager throughout the whole period of observation. Interestingly enough, this company also underwent the fewest change cycles and achieved the least strategic restructuring. Gorenje, Končar and Ljubljanske mlekarne had two general managers, and Lek, Lura and Podravka had three (in the case of Lek, however, Dragonja initiated the period, left, and then returned after the company experienced significant difficulties in his absence).

The ability to clearly define the trigger for change prior to every new cycle is of capital importance for the research model, since the trigger phase is one of its three principal building blocks. The observations from the cases fully confirm the predictions of the research model. All the cycles with a clearly defined nature (defensive or strategic) also had a clearly defined trigger. It is worth noting, however, that the word “trigger” may be somewhat inappropriate,

<sup>120</sup> Cycle is just starting and all elements of organizational template are still not clear.

since its standard semantic meaning implies a brief event involving a one-time assessment of a situation and produces a discontinuity between “before” and “after”. In reality, triggers here often consisted of a sequence of events that were individually assessed and which cumulatively generated a certain perception. While this perception changed continuously, at some point it changed enough in nature to prompt the management to initiate a new cycle of change.

Triggers preceding the periods of non-aligned change were also present, i.e. the management did assess the changing external and internal context. However, the result of the assessment was either an estimated low urgency of change, or an estimated low probability of success in instituting change, or both.

An important observation, however, is that in all cases the change course set after the trigger was deliberate and not “emerging”. This is true even in the case of non-aligned change. In several change cycles, as discussed below, the goals of change were not achieved, but initial principal decisions regarding the new organizational template were nevertheless made prior to attempting the change. In several cases the elements of the organizational template were modified during the same change cycle, but this never fundamentally influenced the nature of that cycle’s change.

## **6.2 Analysis of the factors influencing the trigger phase**

The first two research questions concerned the trigger phase:

- Q1. What factors influenced the perceived need for change? In particular, what factors influenced the perceived time horizon required for action?
- Q2. What factors influenced the perceived feasibility of change?

Although the research model did not suggest a separate set of factors influencing the perceived urgency and the perceived feasibility of change, the field study attempted to provide explicit answers to the above questions. It yielded detailed enough observations to facilitate a separate analysis of the two groups of factors.

### **6.2.1 Summary of observations from individual cases**

Tables 6.2 to 6.8 present an overview of the factors influencing the perceived need for and the perceived feasibility of change for all 7 companies and 25 change cycles. Since all of these items were discussed in the individual case analyses, no additional discussion is provided here.

| Change cycle             | Perceived need & time horizon                                                                                                                                                                                                                                                                                                                                                                                                               | Perceived feasibility                                                                                                                                                                                                                                                                                                                                                                            |
|--------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.1 <sup>121</sup> | <ul style="list-style-type: none"> <li>• Running out of financial slack</li> <li>• Lack of performance transparency</li> <li>• “Want to look good”</li> <li>• Restructuring model used by Iskra worked</li> <li>• Must maintain employment</li> <li>• Change at the top</li> </ul>                                                                                                                                                          | <ul style="list-style-type: none"> <li>• Mature industry implies difficulty to increase volume</li> <li>• Low-value products</li> <li>• Non-core products not competitive outside Slovenia, which is too small</li> <li>• No financial resources to invest in new markets and products</li> <li>• People trust company and are loyal</li> <li>• Stanič is proven and committed leader</li> </ul> |
| Gorenje.2                | <ul style="list-style-type: none"> <li>• No immediate liquidity crisis but still underperforming</li> <li>• Reasons for poor performance more transparent: need lower costs and higher margins</li> <li>• Privatization is not related to changes</li> <li>• Must maintain employment</li> </ul>                                                                                                                                            | <ul style="list-style-type: none"> <li>• Secured financial resources for investment in R&amp;D</li> <li>• Kept technical talent</li> <li>• Maintained distribution in Western Europe</li> <li>• Have committed people who trust Stanič</li> </ul>                                                                                                                                                |
| Gorenje.3                | <ul style="list-style-type: none"> <li>• Need to grow and use opportunities</li> <li>• Owners are happy with returns</li> </ul>                                                                                                                                                                                                                                                                                                             | <ul style="list-style-type: none"> <li>• Growth opportunities exist in CEE</li> <li>• Changes in consumer behavior create space for new value adding products</li> <li>• Opportunities for diversification</li> <li>• Growing availability of resources</li> <li>• Strong brand in some markets</li> <li>• Have committed people who trust Stanič</li> </ul>                                     |
| Gorenje.4                | <ul style="list-style-type: none"> <li>• No crisis, but financial performance below industry average</li> <li>• Owners may require higher returns, potential threat of hostile takeover</li> <li>• High growth is matter of survival</li> <li>• EU-related threats and opportunities approach</li> <li>• Growth may require change of culture</li> <li>• New top team wants to prove it is at least at the level of previous one</li> </ul> | <ul style="list-style-type: none"> <li>• Industry and market dynamics create opportunity for growth and differentiation, but also pose threats</li> <li>• More needed skills in place</li> <li>• Continuity in trust and leadership despite new top team</li> </ul>                                                                                                                              |

Table 6.2 The most important factors influencing the context assessment for Gorenje

<sup>121</sup> Throughout this chapter “Company.n” stands for the n<sup>th</sup> change cycle in the respective company (e.g. Gorenje.1 stands for the first change cycle at Gorenje).

| Change cycle | Perceived need & time horizon                                                                                                                                                                                                                                               | Perceived feasibility                                                                                                                                                                                                                                                                                                                                  |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Kolinska.1   | <ul style="list-style-type: none"> <li>• Scenario predicted severe and immediate financial crisis</li> <li>• Had some financial slack and reasonable insight into financial performance</li> <li>• New licensed products can create opportunity for growth</li> </ul>       | <ul style="list-style-type: none"> <li>• Mature industry limits opportunities</li> <li>• No differentiating resources and no financial strength to build them</li> <li>• Have solid manufacturing competence</li> <li>• Employees will cooperate if soft approach to downsizing is used</li> </ul>                                                     |
| Kolinska.2   | <ul style="list-style-type: none"> <li>• No immediate crisis if short-term profitability acceptable for the owners</li> <li>• Licensing model works</li> <li>• Acquisition opportunities will solve growth problem</li> <li>• Older executives prefer status quo</li> </ul> | <ul style="list-style-type: none"> <li>• Some financial resources and excellent domestic sales and distribution</li> <li>• No differentiating resources and no financial strength to build them, thus limited organic growth</li> <li>• Not attractive for strategic partners beyond current model</li> <li>• Younger executives frustrated</li> </ul> |

Table 6.3 The most important factors influencing the context assessment for Kolinska

| Change cycle | Perceived need & time horizon                                                                                                                                                                                                                | Perceived feasibility                                                                                                                                                                                                                                                                                                                                              |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Končar.1     | <ul style="list-style-type: none"> <li>• No transparency of performance</li> <li>• Financial collapse</li> <li>• Restructuring model used by Iskra worked</li> <li>• Change at the top</li> </ul>                                            | <ul style="list-style-type: none"> <li>• Extremely hostile market situation</li> <li>• No resources to build competence needed to access markets, which would provide needed volume</li> <li>• Easier if everyone fights alone</li> </ul>                                                                                                                          |
| Končar.2     | <ul style="list-style-type: none"> <li>• No transparency of performance</li> <li>• Survived, but still in immediate jeopardy</li> <li>• Slow pace is better choice than high risk</li> </ul>                                                 | <ul style="list-style-type: none"> <li>• Holding company has no financial resources</li> <li>• Market in the region has regained some potential</li> <li>• Diversification can help exploit entrepreneurial opportunities</li> <li>• Divisions may see clearer picture</li> <li>• Kept core technical talent</li> </ul>                                            |
| Končar.3     | <ul style="list-style-type: none"> <li>• More transparent divisional performance</li> <li>• Change at the top</li> <li>• Problems due to lack of leadership in the past</li> <li>• Bago believes that no growth equals slow death</li> </ul> | <ul style="list-style-type: none"> <li>• Divisions are more powerful than the holding company</li> <li>• Industry and market dynamics are favorable</li> <li>• Have core technical talent</li> <li>• Have good regional brand</li> <li>• Potential synergies exist, they are key for growth</li> <li>• Bago has reputation as successful, strong leader</li> </ul> |

Table 6.4 The most important factors influencing the context assessment for Končar

| Change cycle | Perceived need & time horizon                                                                                                                                                                                                                                                                                             | Perceived feasibility                                                                                                                                                                                                                                                                                                                                                                                              |
|--------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Lek.1        | <ul style="list-style-type: none"> <li>• Financial situation worse than expected</li> <li>• Strategy in principle good for core business, not good for the rest</li> <li>• Performance relatively transparent</li> <li>• Have to keep image of successful company</li> <li>• Should avoid stringent downsizing</li> </ul> | <ul style="list-style-type: none"> <li>• Industry and market dynamics not favorable</li> <li>• Have limited financial resources</li> <li>• Dragonja is proven and committed leader</li> </ul>                                                                                                                                                                                                                      |
| Lek.2        | <ul style="list-style-type: none"> <li>• Privatization requires no change</li> <li>• Licensing policy will not work</li> <li>• Competing in USA requires significant changes</li> </ul>                                                                                                                                   | <ul style="list-style-type: none"> <li>• Although not in abundance, have all critical resources</li> <li>• Window of opportunity in CEE for branded generics</li> <li>• In long run all big generic companies must compete in USA</li> <li>• Trust and leadership continuity</li> </ul>                                                                                                                            |
| Lek.3        | <ul style="list-style-type: none"> <li>• No need for major strategy change</li> <li>• New leader unfamiliar with the industry</li> <li>• Growing pluralism of interests among stakeholders</li> <li>• Crisis situation in the market with potential dire consequences</li> </ul>                                          | <ul style="list-style-type: none"> <li>• Do not have all critical resources</li> <li>• Stakeholders are powerful</li> </ul>                                                                                                                                                                                                                                                                                        |
| Lek.4        | <ul style="list-style-type: none"> <li>• Previous leadership was weak</li> <li>• Must achieve strong growth to remain successful</li> <li>• New technologies will increase R&amp;D-related risks</li> </ul>                                                                                                               | <ul style="list-style-type: none"> <li>• Huge growth opportunities exist, both in short and long run</li> <li>• Dragonja is proven and committed leader</li> <li>• Clear performance benchmark</li> <li>• Have excellent resources but need complementary resources from strategic partner to use all growth potential</li> <li>• Can influence stakeholders and change ownership if acting responsibly</li> </ul> |

Table 6.5 The most important factors influencing the context assessment for Lek



| Change cycle | Perceived need & time horizon                                                                                                                                                                                                                                                    | Perceived feasibility                                                                                                                                                                                                             |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| LM.1         | <ul style="list-style-type: none"> <li>• No need to change the way of doing business</li> <li>• Non-clarity of true financial situation</li> </ul>                                                                                                                               | <ul style="list-style-type: none"> <li>• Market pressures</li> <li>• Have needed financial resources but limited competence</li> <li>• Middle managers do not cooperate</li> </ul>                                                |
| LM.2         | <ul style="list-style-type: none"> <li>• Opportunity to grow through acquisition</li> <li>• Want to “look good”</li> <li>• Owners have conflicting priorities</li> </ul>                                                                                                         | <ul style="list-style-type: none"> <li>• Market pressures</li> <li>• Have limited financial resources</li> <li>• Have limited competence</li> <li>• Middle managers do not cooperate</li> <li>• Must please key owners</li> </ul> |
| LM.3         | <ul style="list-style-type: none"> <li>• Urbanija’s leadership was ineffective and led to crisis</li> <li>• Poor transparency of performance but estimated mid-term financial problems</li> <li>• Growing plurality of key stakeholder interests</li> </ul>                      | <ul style="list-style-type: none"> <li>• Have less competence than believed</li> <li>• Must please key stakeholders</li> <li>• Opportunity to grow in the region</li> <li>• Vehovec is trusted leader</li> </ul>                  |
| LM.4         | <ul style="list-style-type: none"> <li>• Better clarity of performance</li> <li>• Expansion into new markets is needed to remain viable</li> <li>• New industry and market dynamics due to EU, including threat of hostile takeover, require substantial improvements</li> </ul> | <ul style="list-style-type: none"> <li>• Have some competence</li> <li>• Might need strategic partner</li> <li>• Must keep key stakeholders happy</li> <li>• Vehovec is trusted leader</li> </ul>                                 |

Table 6.6 The most important factors influencing the context assessment for Ljubljanske mlekarne

| Change cycle | Perceived need & time horizon                                                                                                                                                                                                                                                                                                                                                                 | Perceived feasibility                                                                                                                                                                                                                                                                                                               |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Lura.1       | <ul style="list-style-type: none"> <li>• Opportunity to grow by acquisition</li> <li>• Have advantage over competition</li> <li>• Want to “look good”</li> <li>• Should maintain employment</li> </ul>                                                                                                                                                                                        | <ul style="list-style-type: none"> <li>• Difficult market</li> <li>• Limited financial resources</li> <li>• Limited competence in some key areas</li> <li>• Raić has power of owner-manager</li> </ul>                                                                                                                              |
| Lura.2       | <ul style="list-style-type: none"> <li>• Potential financial crisis due to opening of the local market</li> </ul>                                                                                                                                                                                                                                                                             | <ul style="list-style-type: none"> <li>• Local markets offer low growth potential for dairy products</li> <li>• Need outside management talent</li> <li>• Have solid technical competence</li> <li>• Must be ethically sound in making changes</li> </ul>                                                                           |
| Lura.3       | <ul style="list-style-type: none"> <li>• Growth is a priority</li> <li>• Market pressures increase</li> <li>• Window of opportunity for finding acquisition targets and strategic partner</li> </ul>                                                                                                                                                                                          | <ul style="list-style-type: none"> <li>• Unfavorable industry and local market dynamics</li> <li>• Acquisition opportunities in the region</li> <li>• Diversification opportunities in Croatian food industry</li> <li>• Have limited resources, might benefit from strategic partner</li> <li>• Vukina is strong leader</li> </ul> |
| Lura.4       | <ul style="list-style-type: none"> <li>• Limited window of growth opportunities in wider region</li> <li>• Risky to depend on opportunistic acquisitions or reaching agreement with strategic partner</li> <li>• EU enlargement requires profound changes</li> <li>• Better transparency of performance</li> <li>• Vukina’s leadership was ineffective and led to potential crisis</li> </ul> | <ul style="list-style-type: none"> <li>• Have most of the key resources needed, bottleneck in middle management</li> <li>• Diversification opportunities in Croatian food industry</li> <li>• Stronger new top management team</li> </ul>                                                                                           |

Table 6.7 The most important factors influencing the context assessment for Lura

| Change cycle | Perceived need & time horizon                                                                                                                                                                                                                                                                                                                                    | Perceived feasibility                                                                                                                                                                                                                                                                                                                                                                  |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Podravka.1   | <ul style="list-style-type: none"> <li>• Non-transparent performance</li> <li>• Market and industry dynamics imply need for some improvement, but not major change</li> <li>• Strong but non-professional supervisory board</li> <li>• Strong pressures to maintain employment</li> <li>• Conflict of (private) interest on part of senior executives</li> </ul> | <ul style="list-style-type: none"> <li>• Worsening market situation</li> <li>• Limited resources</li> <li>• Poor competence in key areas when benchmarked with new competitors</li> <li>• Political support</li> </ul>                                                                                                                                                                 |
| Podravka.2   | <ul style="list-style-type: none"> <li>• Financial crisis</li> <li>• Must comply with EBRD conditions</li> <li>• Pressures to keep supporting local community</li> <li>• Conflict of (private) interest on part of senior executives</li> </ul>                                                                                                                  | <ul style="list-style-type: none"> <li>• Have conditional access to sufficient financial resources</li> <li>• Have limited competence, especially in non-core businesses</li> <li>• Loyal employees but frustrated and have low trust in leadership</li> </ul>                                                                                                                         |
| Podravka.3   | <ul style="list-style-type: none"> <li>• No immediate financial danger, but still underperforming</li> <li>• Poor transparency of results</li> <li>• Pressures to keep supporting local community</li> <li>• Conflict of (private) interest on part of senior executives</li> </ul>                                                                              | <ul style="list-style-type: none"> <li>• Industry and market dynamics are negative</li> <li>• Have access to sufficient financial resources</li> <li>• Have limited competence, especially in management</li> <li>• Could benefit from strategic partner</li> <li>• Strong stakeholders desire only gradual changes</li> <li>• New leader has integrity but is not forceful</li> </ul> |
| Podravka.4   | <ul style="list-style-type: none"> <li>• Ethical crisis due to poor leadership</li> <li>• Improving transparency of performance</li> <li>• Impact of EU enlargement requires profound changes</li> <li>• Marinac believes that growth is crucial for survival</li> </ul>                                                                                         | <ul style="list-style-type: none"> <li>• Opportunities for growth exist in wider region</li> <li>• Have limited resources but capable of increasing key ones</li> <li>• Could benefit from strategic alliances</li> <li>• Fresh top management team</li> <li>• Can handle key stakeholders</li> </ul>                                                                                  |

Table 6.8 The most important factors influencing the context assessment for Podravka

Grouping the line items identified in the above tables produces a clearer overview of the key factors identified to have influenced the trigger phases of the observed 25 change cycles. According to the research model, the following factors should have influenced management assessment of the perceived urgency and feasibility of change:

1. Institutional pressures, in particular social issues and the question of the firm's purpose; industry practices and mimicking; and cultural pressures;

2. Transparency of performance;
3. Opportunistic behavior (the research model did not predict whether this would lead to a higher or lower rate of change attempts);
4. Sufficiency of critical resources, in particular the role of trusted leadership and financial slack (the research model did not predict whether financial slack would lead to a higher or lower rate of change attempts).

As noted above, the research model did not distinguish between factors influencing the perceived urgency of change and those influencing the perceived feasibility of change. Observations from the field study established a certain correlation between the perceived urgency and the perceived feasibility of change, since in many cases management interpreted the factors contributing to a perceived low feasibility of change as negatively influencing the perceived need for change (below a certain threshold). This is because several factors (e.g. financial slack or unfavorable market situation) influenced both perceived urgency and feasibility, but in the opposite direction. Nevertheless, the decision to use these two variables, although not fully independent, as valid predictors of triggers seems justified, since similar pairs of values produced the same results in terms of change trigger existence or non-existence. Furthermore, as discussed later, the same variables proved valid in predicting the type of response once change was initiated.

Since the observations from the field study allowed the separate identification of factors influencing the perceived urgency of change and those influencing the assessment of change feasibility, they will be presented separately.

#### 6.2.2 Summary of factors influencing perceived change urgency

Table 6.9 groups the factors in accordance with the predictions of the research model, eliminates duplications, but keeps count of repetitions. Cycles marked with \* demonstrate only limited presence of the factor.

| Group of factors                                       | Individual factor                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Change cycles in which the factor was present                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|--------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Issues related to institutional pressures              | <ul style="list-style-type: none"> <li>• “Must look good” leads to denial and decreased perceived urgency of change</li> <li>• Pressures to maintain employment lead to decreased perceived urgency of change</li> <li>• Pluralism of interests leads to decreased perceived urgency of change</li> <li>• Old ways of doing business are seen as effective, thus decreasing perceived urgency of change</li> <li>• Old ways of doing business are seen as ineffective, thus increasing perceived urgency of change</li> <li>• Readiness to mimic successful restructuring practices increases perceived urgency of change</li> <li>• Privatization leads to decreased perceived urgency of change</li> <li>• Owners are happy with status quo, decreased perceived urgency of change</li> <li>• Owners are not happy with status quo (including takeover threat), increased perceived urgency of change</li> </ul> | <ul style="list-style-type: none"> <li>• Gorenje.1, Lek.1, LM.2, Lura.1</li> <li>• Gorenje.1, Gorenje.2, Lura.1, Podravka.1, Podravka.2</li> <li>• Lek.3, LM.2, LM.3, Podravka.1, Podravka.2, Podravka.3</li> <li>• Kolinska.2, Lek.3, LM.1, Lura.1, Podravka.1</li> <li>• Gorenje.4, Lek.2, Lek.4, LM.4, Lura.3, Lura.4, Podravka.4</li> <li>• Gorenje.1, Končar.1</li> <li>• Gorenje.2, Lek.2, Podravka.1</li> <li>• Gorenje.3, Kolinska.2, Lura.1</li> <li>• Gorenje.4, LM.4, Lura.2, Lura.4, Podravka.2</li> </ul> |
| Financial issues including transparency of performance | <ul style="list-style-type: none"> <li>• Lack of performance clarity and lack of indication of future financial difficulties decreased perceived urgency of change</li> <li>• Performance clarity and indication of future financial difficulties increased perceived urgency of change</li> <li>• Financial crisis created high perceived urgency of change</li> <li>• Financial underperformance detected by top management increased perceived urgency of change</li> <li>• Financial slack decreased perceived urgency of change</li> </ul>                                                                                                                                                                                                                                                                                                                                                                    | <ul style="list-style-type: none"> <li>• Kolinska.2, Končar.2, LM.1, Lura.1, Podravka.1, Podravka.3</li> <li>• Gorenje.2, Kolinska.1, Končar.3, Lek.1, LM.3, Lura.2, Lura.4, Podravka.4</li> <li>• Gorenje.1, Končar.1, Podravka.2</li> <li>• Gorenje.2, Gorenje.4, Končar.3, Lek.1, Podravka.3</li> <li>• Kolinska.1, Lek.1</li> </ul>                                                                                                                                                                                |

Table 6.9 Factors influencing the assessment of change urgency

| Group of factors                           | Individual factor                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | Change cycles in which the factor was present                                                                                                                                                                                                                                                                            |
|--------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Issues related to opportunities and growth | <ul style="list-style-type: none"> <li>• Opportunistic behavior decreases focus and perceived urgency of change</li> <li>• Opportunistic acquisitions, alliances or strategic partners are used as “silver bullets” and decrease perceived urgency of change</li> <li>• Growth is seen as matter of survival, which increases perceived urgency of change</li> <li>• Growth is seen as requiring substantial changes and appropriate time, which increases perceived urgency of change</li> </ul> | <ul style="list-style-type: none"> <li>• Gorenje.2, Gorenje.3, Kolinska.1, LM.2, Lura.1, Lura.3</li> <li>• Kolinska.2, Lura.3</li> <li>• Gorenje.4, Končar.3, Lek.4, LM.4, Lura.4, Podravka.4</li> <li>• Gorenje.4, Lek.2, LM.4</li> </ul>                                                                               |
| Issues related to leadership               | <ul style="list-style-type: none"> <li>• Top team wants stability or avoids change, thus decreasing perceived urgency of change</li> <li>• Change at the top increased perceived urgency of change</li> <li>• Ineffective leadership in previous period increased perceived urgency of change</li> <li>• Top team wants to prove itself, thus increasing perceived urgency of change</li> </ul>                                                                                                   | <ul style="list-style-type: none"> <li>• Kolinska.2, Končar.2, Lek.3, LM.2, Podravka.1, Podravka.3</li> <li>• Gorenje.1, Gorenje.4, Končar.1, Končar.3, Lek.3*, Lek.4, LM.3, Lura.1, Lura.3, Lura.4, Podravka.3, Podravka.4</li> <li>• Končar.3, Lek.4, LM.3, Lura.4, Podravka.4</li> <li>• Gorenje.4, Lura.4</li> </ul> |

Table 6.9 Factors influencing the assessment of change urgency (continued)

Although there are certain differences between the factors identified in the research model and those identified in the field study and summarized in Table 6.9, they are not of fundamental importance. While the findings from the field study suggest that some refinements to the research model should be made, they also confirm that the research model of the trigger phase was in principle correct and in its improved form can remain part of the overall model.

First among the research model’s proposed factors influencing the assessment of change urgency were various institutional pressures, in particular social issues and the question of the firm’s purpose, industry practices and mimicking, plus cultural pressures. The field study confirmed the importance of institutional pressures, although with a somewhat differently-detailed structure. Social pressures as an important institutional factor were primarily manifested in the pressure to maintain employment, pressure to “look good”, and pressure to maintain a high level of support for the local community and other important stakeholders, even if this meant a potential conflict of interest with other company priorities. All of these pressures influenced management in the same way, by decreasing the perceived urgency of change.

Observing industry practices and comparing them with the company’s own practices was a highly influential institutional factor, seen as having a major impact on the final assessment in

more than half of change cycles. This is not surprising, especially when linked with the observed pattern. Assessments leading to a lower perceived urgency of change were typically seen in early change cycles, when the company in question had no access to global benchmarks and the assessment simply reinforced an otherwise negative attitude towards learning and the feasibility of change. On the other hand, assessments of industry practices leading to a higher perceived urgency of change typically appeared in more recent change cycles, were accompanied by greater openness to learning, and resulted in strategic restructuring.

Mimicking successful change practices was also identified as a factor influencing assessment. A particularly interesting example is the influence of the restructuring model developed by the large and previously very successful Slovenian electronics conglomerate, Iskra. Two of the companies observed utilised Iskra's experience in assessing their own situations and change urgency, deciding that they should interpret the environment in the same way as Iskra's management and make the same response. In Iskra's case the chosen approach to change led eventually to the decline of the corporation, which lost its value adding capabilities almost entirely. Less vital units went bankrupt, while the most vital survived as independent entities. It seems that this result was acceptable to the companies observed, primarily as their leaderships at the time of the trigger estimated that the only other alternative was collective collapse.

The effect of privatization as a factor leading to a decreased perceived urgency of change may sound surprising, but has a simple and logical explanation. It was not, as one might expect, that managers hesitated to initiate major changes just before privatization, preferring to wait for their owners' blessing. Quite the contrary: management felt that the likely ownership structure after privatization would set up a situation where owners would be unwilling to decide major issues against the recommendations of management. It should be noted that this was not universally true, since in some of the observed companies management showed an early concern with the interests of the owners. The difference in perception may be primarily due to a management self-assessment, whereby managers with more self-confidence and a firm belief that they could cope with change paid less attention to the privatization process and the new owners. However, the influence of owners seemed to grow over time for all the companies observed.

While transparency of performance was identified in the research model as a factor separate from financial resources (which were grouped with other resources), the field study showed that it is more convenient to group these two factors together. Performance transparency affected the urgency assessment as predicted, low transparency decreasing perceived urgency. As expected, high transparency led to higher perceived urgency only when it was coupled with a prediction of future financial difficulties. The important consequence of the transparency issue is the observation that low transparency led in several cases to financial collapse before the company had clearly identified the scale of the threat, and in several other cases delayed change and resulted in more pronounced defensive reactions. Financial underperformance was, generally speaking, an important factor increasing the perceived urgency of change.

The question left open by the research model was the role of financial slack. In terms of its influence on urgency assessment, it is clear that the existence of slack had a negative impact and decreased perceived urgency.

The next factor predicted by the research model was the influence of opportunistic behavior, although the research model did not predict the direction of influence. The field study clearly showed that in cases when management exhibited opportunistic behavior this decreased the perceived urgency of change. It was interesting in particular to observe how some top management teams “waited for the right opportunity”. Although it is difficult to assess completely objectively the process they engaged in, from external manifestations and the testimonials collected it seems that they did not define the nature of “opportunity” clearly, failed to search consistently for it, and did not support their strategy with other activities which would aid the company in finding and taking advantage of it. On the other hand, in several cases companies acted in exactly the opposite manner, firstly defining their strategic ambition and following this up with a search for appropriate opportunities. Since the first pattern better matches the definition of opportunistic behavior, the conclusion from the research is that it decreases the perceived urgency of change.

Another factor to some degree related to the notion of opportunity – one not identified in the research model based on theory review – cropped up in the field study as important. This is the influence of how top management perceived growth. In all the cases observed where top management perceived growth as vital for company viability, the perception increased the perceived urgency of change. It is interesting to note that in several cases the influence of this factor was amplified by the assessment that growth required substantial changes, and these in turn a significant amount of time. In these cases management was not paralyzed by the “immensity of the task”, but was actually stimulated to move at a quicker pace.

Resource availability, in particular trusted leadership, was the last factor predicted by the research model as potentially influencing the perceived urgency of change. While other resources were identified as influencing the perceived feasibility of change and will be discussed later, an influence of leadership-related issues on perceived change urgency was observed in the field study. In several cases, where the members of top management clearly regarded the status quo as a personal priority and for various reasons did not want to engage in change, this influence was obviously negative. In these cases a negative attitude towards change was rationalized through a one-sided interpretation of context, even where other members of their organizations and other players in the industry interpreted the same context as requiring change.

Change at the top almost always coincided with an increase in perceived urgency. The exceptions were situations where this effect was attenuated by a new leader who showed clear weaknesses (and was not pushed by external factors into radical defensive restructuring). In six observed change cycles poor leadership in the previous period was seen as so detrimental to the company that it provoked an assessment of urgent need for change. In several other cases perceived urgency of change was increased by the desire of the top management team to establish itself as successful and to make its mark on company history, this rationalized with by an interpretation of the context as requiring urgent change.

### 6.2.3 Summary of factors influencing perceived change feasibility

Table 6.10 groups these factors in accordance with the predictions from the research model. Once again, factors with a slightly different description but of essentially the same nature were pooled together, and change cycle numbers are given for the cycles in which the factors significantly influenced the assessment of change feasibility. Cycles marked with \* demonstrate only limited presence of the factor.



| Group of factors                                     | Individual factor                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Change cycles in which the factor was present                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Issues related to institutional pressures            | <ul style="list-style-type: none"> <li>• Estimate of not being able to handle stakeholders in expected delicate situation decreased perceived feasibility of change</li> <li>• Estimate of being able to handle stakeholders in expected delicate situation increased perceived feasibility of change</li> </ul>                                                                                                                                                                                                                                                                                                                                                                            | <ul style="list-style-type: none"> <li>• Končar.2, Končar.3, Lek.3, LM.3, LM.4, Lura.2, Podravka.3</li> <li>• Lek.4, Podravka.4</li> </ul>                                                                                                                                                                                                                                                                                                                                                                        |
| Issues related to industry and market dynamics       | <ul style="list-style-type: none"> <li>• Estimate of industry and market dynamics as unfavorable decreased perceived feasibility of change</li> <li>• Estimate of industry and market dynamics as favorable increased perceived feasibility of change</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                            | <ul style="list-style-type: none"> <li>• Gorenje.1, Kolinska.1, Kolinska.2, Končar.1, Lek.1, Lek.3, LM.1, LM.4, Lura.1, Lura.2, Lura.3, Podravka.1, Podravka.3</li> <li>• Gorenje.4, Končar.2, Končar.3, Lek.2, Lek.4, LM.3, Lura.3, Lura.4, Podravka.4</li> </ul>                                                                                                                                                                                                                                                |
| Issues related to resource (competence) availability | <ul style="list-style-type: none"> <li>• Estimate of insufficient financial resources decreased perceived feasibility of change</li> <li>• Estimate of sufficient financial resources increased perceived feasibility of change</li> <li>• Estimate of poor current level of competitiveness and competence and of no differentiating resources decreased perceived feasibility of change</li> <li>• Estimate of having some competence and differentiating resources increased perceived feasibility of change</li> <li>• Estimate that the needed competence and complementary resources could be obtained through strategic partner increased perceived feasibility of change</li> </ul> | <ul style="list-style-type: none"> <li>• Gorenje.1, Kolinska.1, Končar.1, Končar.2, Lek.1*, Lura.1, Podravka.1*</li> <li>• Gorenje.2, Gorenje.3, Lek.2, Lek.3, Lek.4, LM.1, LM.2*, Podravka.2, Podravka.3</li> <li>• Gorenje.1*, Kolinska.1, Kolinska.2, Končar.1, Lek.3*, LM.3, Lura.1*, Podravka.1*, Podravka.2, Podravka.3</li> <li>• Gorenje.2, Gorenje.3, Kolinska.1, Kolinska.2, Končar.3, Lek.2, Lek.4, LM.2*, LM.4, Lura.2, Lura.4, Podravka.4</li> <li>• LM.4, Lura.3, Podravka.3, Podravka.4</li> </ul> |

Table 6.10 Factors influencing the assessment of change feasibility

| Group of factors             | Individual factor                                                                                                                                                                                                                                                                                                       | Change cycles in which the factor was present                                                                                                                                                                                                                                                  |
|------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Issues related to leadership | <ul style="list-style-type: none"> <li>• Estimate of cooperative employees increased perceived feasibility of change</li> <li>• Estimate of uncooperative employees decreased perceived feasibility of change</li> <li>• Estimate of strong and trusted leadership increased perceived feasibility of change</li> </ul> | <ul style="list-style-type: none"> <li>• Gorenje.1, Gorenje.2, Gorenje.3, Kolinska.1</li> <li>• Kolinska.2, LM.1, LM.2, Podravka.2, Podravka.3</li> <li>• Gorenje.1, Gorenje.2, Gorenje.3, Gorenje.4, Končar.3, Lek.1, Lek.2, Lek.4, LM.3, LM.4, Lura.1, Lura.2, Lura.4, Podravka.4</li> </ul> |

Table 6.10 Factors influencing the assessment of change feasibility (continued)

Institutional pressures, as the first factor suggested by the research model, according to the findings from the field study significantly influenced the perceived feasibility of change in a very simple way. In a large number of change cycles observed, where the potential outcome of change was regarded as sensitive and against the interests of some key stakeholders, top management made an explicit assessment of their ability to handle the stakeholders. Where the assessment was negative, top management designed the change around the notion of low feasibility, while a positive assessment resulted in increased perceived feasibility of change.

A similarly simple but powerful factor influencing the perceived feasibility of change was the assessment of industry and market dynamics. It is interesting to note that this assessment was made explicit and non-neutral in nearly 75% of the change cycles observed. In all of these cases top management directly linked the assessment of the industry and market situation facing the company with the perceived feasibility of change, a positive assessment increasing perceived feasibility.

A similar level of straightforward influence was observed for the assessment of available financial resources and business competence. Sufficiency of resources increased the perceived feasibility of change, while an estimated insufficiency decreased it. It is also unsurprising that the estimated possibility of obtaining needed resources through a strategic partner influenced the perceived feasibility of change positively.

People-related factors were also observed to act according to the predictions of the research model. In particular, in more than half of the observed change cycles a high level of top management self-confidence (i.e. when top managers viewed themselves as trusted leaders) positively influenced the assessment of change feasibility.

### 6.3 Analysis of the design phase outcomes

The third research question concerned the outcome of the design phase:

Q3. What was the pattern of response to the perceived time horizon for action and the perceived feasibility of change, if any? What was the sequence of responses?

Before presenting a graphic illustration of the sequence of observed change cycles it is worth reminding the reader of the methodology by which the diagram values presented in Chapter 4 were calculated. Despite rough calculation, in no case was there a mismatch between the predicted change cycle characteristics based on an estimated position in the diagram and the observed change cycle characteristics identified in the field study.

It is also important to note that in all cycles several factors influenced management assessment of change urgency and feasibility. In many cases some factors had contrasting influences and the net direction of influence was a balance among them. The fact that the field study did not identify any single factor as being generally present in all change cycles does not come as a surprise. The diversity of the observed situations suggests that complete homogeneity of the factors influencing the assessment would be unlikely.

Finally, as previously noted, the trigger phases of most change cycles stretched over a period of time. However, the boundaries between trigger and design phases were relatively clear. On the other hand, while the design phases were typically shorter than the trigger phases, the boundaries between the design phases and the implementation phases were less clear. Companies often began implementing some elements of design before coming up with a full complement, but in all the change cycles observed the principle change outcomes of the design phase (or their positioning in the diagrams presented in Figures 6.1 through 6.7) were determined early on.

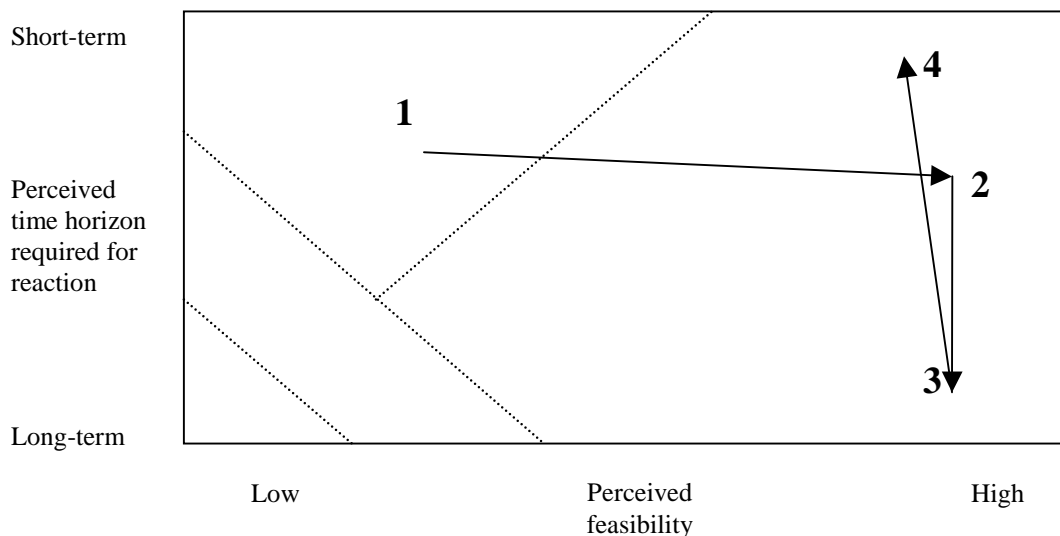


Figure 6.1 Sequence of change at Gorenje

Due to low perceived feasibility, the research model predicted that the first change cycle at Gorenje would be defensive. As a result of a big increase in perceived feasibility, the next three should have been strategic. It is interesting to note a drop in perceived urgency for the third cycle and then an increase in the fourth. However, while modification of some of the change manifestations was expected, the nature of change should have remained the same.

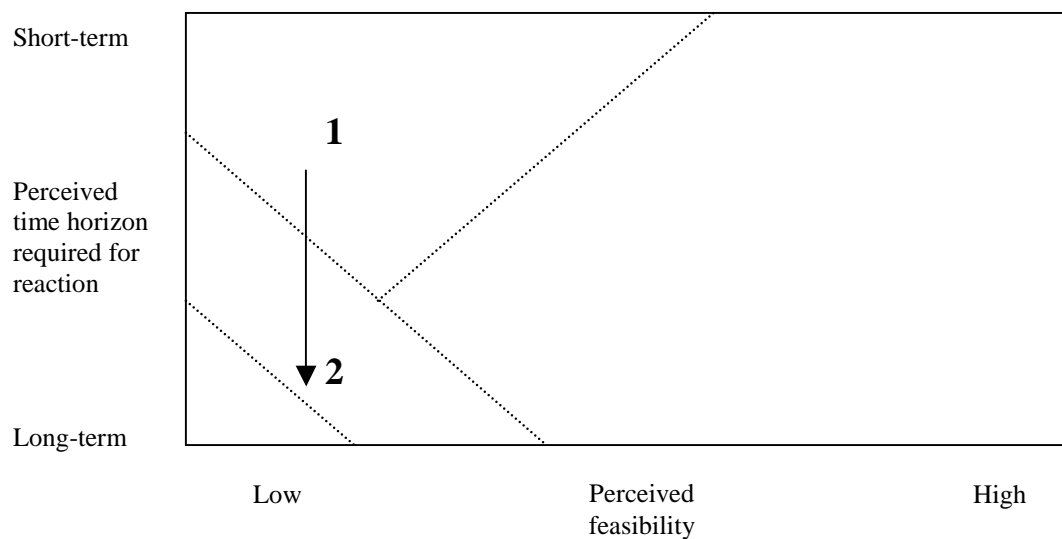


Figure 6.2 Sequence of change at Kolinska

Due to low perceived feasibility and high perceived urgency, the first cycle of change at Kolinska was expected to be defensive. However, since perceived urgency in the second cycle decreased and perceived feasibility remained the same, the research model predicted that Kolinska would enter a period of non-aligned change.

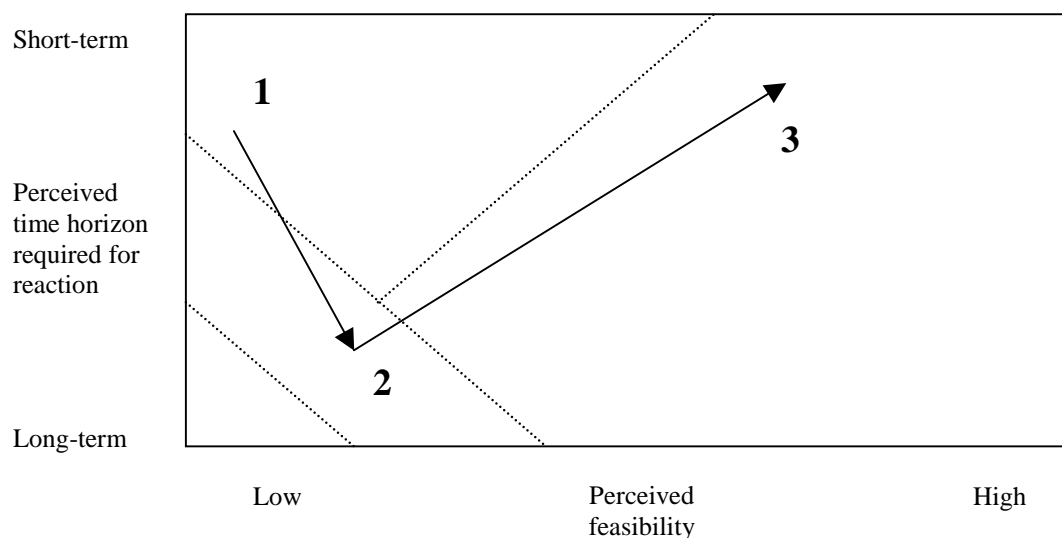


Figure 6.3 Sequence of change at Končar

The first change cycle at Končar was expected to be clearly defensive, since perceived urgency there was high and perceived feasibility extremely low. When perceived urgency decreased and perceived feasibility only slightly increased, the research model predicted that the company would enter a period of non-aligned change. In the last period perceived urgency again increased, but since perceived feasibility also significantly increased, the model predicted that the nature of change would become strategic.

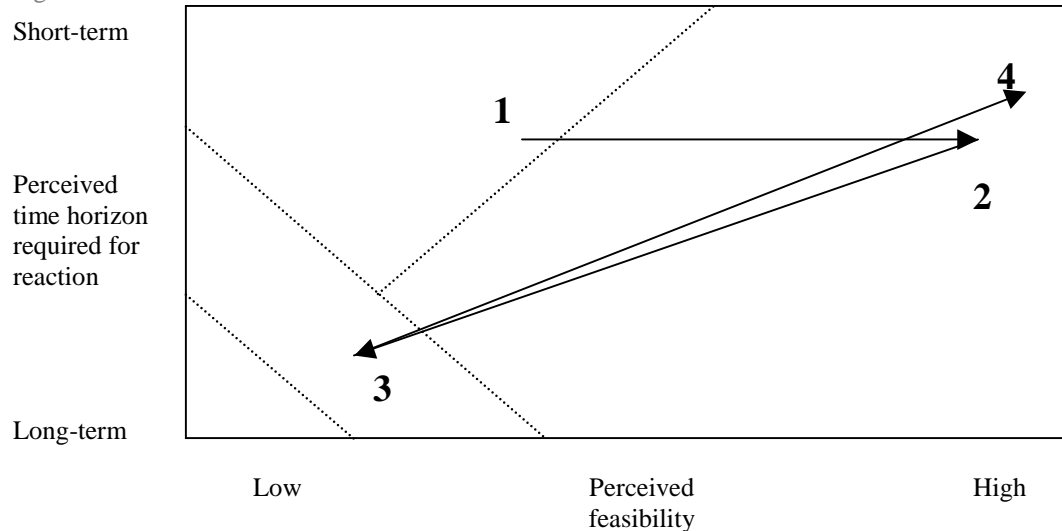


Figure 6.4 Sequence of change at Lek

The first change cycle at Lek was marked by relatively high perceived urgency and low-to-medium perceived feasibility. Therefore the research model predicted that the cycle would contain some characteristics of strategic restructuring, although its predominant nature would be defensive. After seeing increased feasibility in the second cycle, both perceived urgency and feasibility were decreased, which should have resulted in non-aligned change in the third cycle. Due to high perceived urgency and feasibility the fourth cycle again was expected to assume all the characteristics of strategic restructuring.

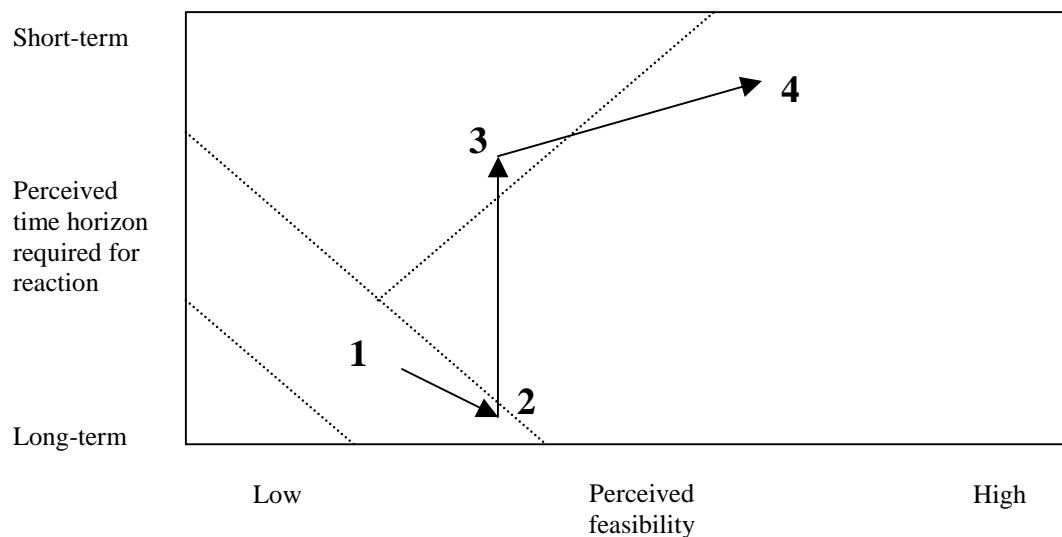


Figure 6.5 Sequence of change at Ljubljanske mlekarne

Due primarily to low perceived urgency, it was expected that the first two change cycles at Ljubljanske mlekarne would be dominated by the attributes of non-aligned change, although the second cycle should also have had some attributes of strategic change. Since perceived urgency increased in the third cycle, the latter was expected to be predominantly defensive, although also to have some attributes of strategic change. The research model predicted that only the fourth cycle would possess more clear attributes of strategic restructuring.

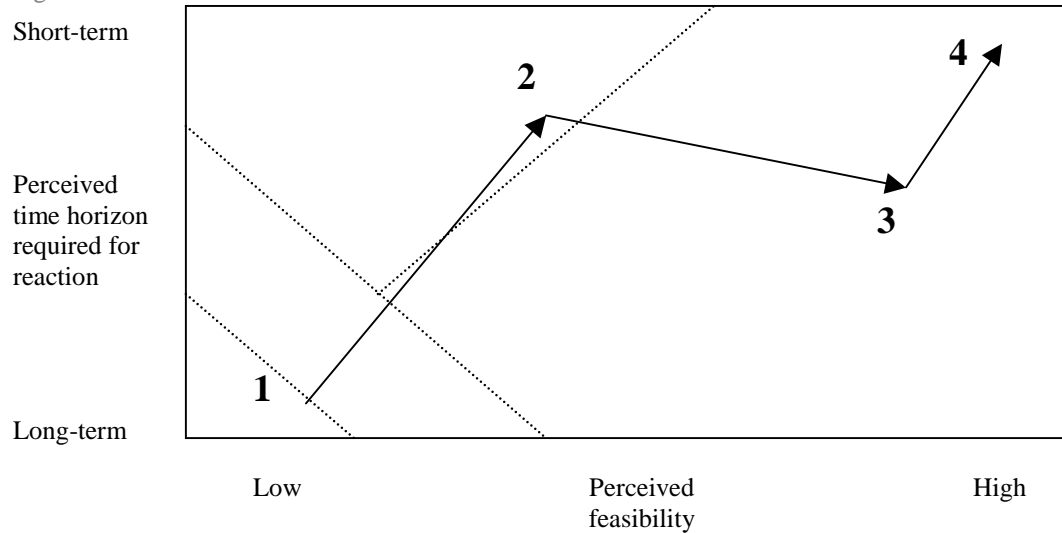


Figure 6.6 Sequence of change at Lura

Due to both very low perceived urgency and low perceived feasibility, the research model predicted no major changes in the first change cycle at Lura. A significant increase in perceived urgency was matched by only a minor increase in perceived feasibility, and thus the second cycle was expected to be primarily defensive, but also to possess some of the attributes of strategic restructuring. The model predicted that the last two cycles would clearly have the nature of strategic restructuring.

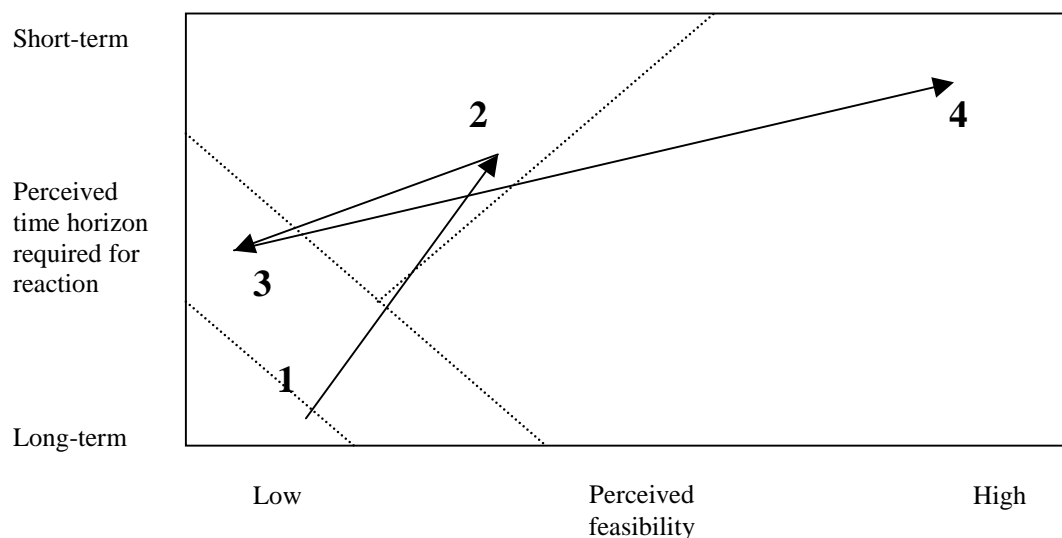


Figure 6.7 Sequence of change at Podravka

The research model predicted that due to low perceived urgency and low perceived feasibility only minor changes would be attempted in the first change cycle at Podravka. A major increase in perceived urgency and a minor increase in perceived feasibility should according to the model have led to defensive restructuring in the second cycle, while the drop in perceived feasibility was expected to produce non-aligned change in the third. Finally, a major increase in perceived feasibility in the fourth cycle should have produced strategic restructuring.

Several observations concerning the outcomes of design phases and the sequence of change cycles merit more detailed discussion.

The main conclusion of the field research is that the observed nature of the new organizational templates fully matched the predictions of the research model. As discussed later, not only did the observations confirm that individual cycles possessed the expected dominant characteristics (e.g. defensive or strategic restructuring), but they also held true for the cycles, for which the research model predicted that the design phase would produce a new organizational template with somewhat mixed characteristics (the first change cycle at Lek, for example, indeed had the predominant attributes of defensive restructuring mixed with attributes which are otherwise typical of strategic restructuring).

As predicted by the research model, cycles in which the management saw no need for change were always followed by defensive restructuring (in one case after an intermediate cycle of non-aligned change). This may indicate that in an environment marked by abrupt and threatening changes companies cannot afford to follow a “business as usual” philosophy, since it will inevitably lead them into difficulties.

On the other hand, all the cycles of non-aligned change that were preceded by defensive restructuring were followed by strategic restructuring (early indications of the next cycle of change at Kolinska also point in the direction of strategic restructuring). This goes against logic, since one would expect non-aligned change to have the same detrimental effect, or worse, as absence of change (e.g. energy and resources wasted, credibility lost). However, it is important to note that all observed cases of non-aligned change were linked to weak leadership. When an appropriate leader appeared and a new cycle began, the same basic context was interpreted differently and strategic restructuring suddenly became feasible. This reminds us of the old saying that “there is no easy or difficult golf course, just good and bad golf players”.

Another group of observations from the field study involve the length of individual cycles and the overall restructuring process. The longest cycle was the second cycle at Kolinska, characterized as non-aligned change and lasting for more than ten years (with indications of a new trigger phase appearing soon). Otherwise, the duration of concluded change cycles varied from two to seven years.

It is interesting to note that the cycles characterized as defensive restructuring lasted from two to three years. The two defensive restructuring cycles lasting three years were associated with a late reaction to context change and significant financial crisis (in one case this amounted to near-bankruptcy). The two years needed for the shorter defensive restructuring cycles seemed to be the minimum period required for systematic change.

Not surprisingly, the defensive change cycles had, as a group, the shortest average duration. The longest average duration belonged to the group of cycles characterized as “no change”. However, one should be cautious in making generalizations here, not only because the sample is very small but also because the findings may be highly influenced by the context (e. g. a food industry with fairly closed local markets).

The conclusions that seem much more appropriate for generalization are those which concern the length of strategic restructuring. On the one hand, the concluded change cycles characterized as strategic restructuring lasted a minimum of three and a maximum of six

years. The only exception was the third change cycle at Lura, which lasted for only two years, but was then terminated as unsuccessful. On the other hand, all the companies undergoing strategic restructuring are still in the process. Only one (Lek) has attained a performance level approaching the leading companies in its industry, but even here the top management has clearly indicated that further restructuring is needed. Obviously, four to nine years spent on strategic restructuring have not been enough, even for those companies acting systematically, with clear commitment from the top and without major mistakes. This might present an interesting topic for future research, investigating whether such long duration stems from the regional context and the poor starting point of change, or whether it is also present in companies with more advantageous starting points, less hostile contexts and more resources to deploy during restructuring.

My final comments are devoted to the clarity of positioning in the diagrams in Figures 6.1 to 6.7. As noted earlier, the values for variable pairs were not determined through exact measurements. A similarly loose methodology was applied to determining the boundaries of regions with the same change characteristics. However, the resulting groupings, presented in Figure 6.8, seem to be consistent and are robustly supported by observations from the field study.

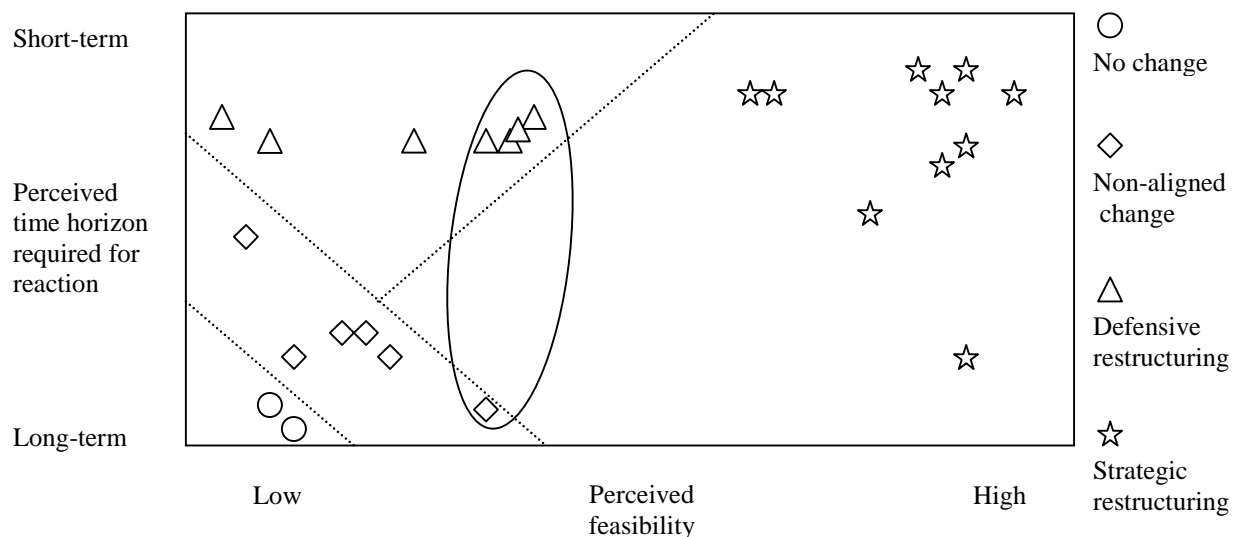


Figure 6.8 Mapping of the observed change cycle trigger values and the resulting design characteristics

As noted above, those change cycles that are markedly close to the region boundary (circled in Figure 6.8; from Figures 6.1 to 6.7 they can be identified as the first cycle at Lek, the second and third change cycles at Ljubljanske mlekarne, the second cycle at Lura, and the second cycle at Podravka) seem to indicate gradual, rather than sudden transitions between the regions. While for all of these cycles the region determined the main characteristics of the change cycle, some characteristics from the neighboring region were also present. This implies another counter-intuitive phenomenon observed during the field study: some change cycles possessed the dominant characteristics of defensive restructuring with some traces of strategic restructuring, and vice-versa.

Once again, it should be stressed that the above positioning reflects the design choices and does not necessarily imply the successful or unsuccessful outcome of the attempted change.



As suggested by the research model and discussed in the next two sections, change outcomes were related to the chosen organizational template, available resources, leadership interventions and barriers to change.

## 6.4 Characteristics of defensive restructuring

The fourth research question focused on the nature and characteristics of defensive restructuring:

Q4. If defensive restructuring was one of the responses, what was its nature? What were the key elements of the new organizational template? What were the key resources needed? What were the main leadership interventions during implementation, and the barriers to successful implementation of the new template?

Out of the seven defensive restructuring cycles observed, five produced the desired results (Gorenje.1, Kolinska.1, Lek.1, LM.3, Lura.2): company financial performance was stabilized and the cost position improved, leading to immediate improvement in competitiveness. At the same time value adding competence was not destroyed, thus allowing the company in question to proceed with strategic restructuring. In the two remaining cases (Končar.1, Podravka.2) some improvements were achieved, but in both cases they proved insufficient for sustainable operations, thus prompting further financial crisis.

### 6.4.1 Organizational templates in defensive restructuring

Table 6.11 presents a summary of the organizational template characteristics observed in the seven defensive restructuring cycles.

| Change cycle | Observed organizational template characteristics                                                                                                                                                                                                                                                                                                                                                       |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.1    | <ul style="list-style-type: none"> <li>• Soft downsizing</li> <li>• Focus on liquidity and costs</li> <li>• Centralization</li> <li>• Reorganization into completely independent divisions, core business kept intact in one of them</li> <li>• Focus on core markets but no change of product portfolio or sales strategy</li> <li>• Quality improvements through technological discipline</li> </ul> |
| Kolinska.1   | <ul style="list-style-type: none"> <li>• Asset restructuring</li> <li>• Soft and hard downsizing</li> <li>• Focus on liquidity and costs</li> <li>• Centralization</li> <li>• Focus on production improvements and domestic sales, including products based on licensing</li> <li>• Unsuccessful attempt to expand exports</li> </ul>                                                                  |

Table 6.11 Observed organizational template characteristics in defensive restructuring cycles

| Change cycle | Observed organizational template characteristics                                                                                                                                                                                                                                                                                                                                                                                                     |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Končar.1     | <ul style="list-style-type: none"> <li>• Bankruptcies on divisional level</li> <li>• Radical downsizing through bankruptcies and bypass companies</li> <li>• Centralized liquidity management</li> <li>• Focus on costs</li> <li>• Reorganization into smaller and more independent divisions</li> <li>• Focus on keeping existing business partners, particularly in domestic market</li> <li>• Improvements in technological discipline</li> </ul> |
| Lek.1        | <ul style="list-style-type: none"> <li>• Focus on core business</li> <li>• Moderate, soft downsizing</li> <li>• Focus on costs through systematic process reengineering</li> <li>• Divisional organization with core business as division</li> <li>• Focus on sales of existing products in core markets</li> </ul>                                                                                                                                  |
| LM.3         | <ul style="list-style-type: none"> <li>• Asset restructuring through plant closures</li> <li>• Soft downsizing</li> <li>• Focus on costs through numerous improvement projects</li> <li>• Centralization</li> <li>• Reorganizations within functional organization</li> <li>• Focus on existing products, domestic sales and distribution, in particular relations with retail chains (introduction of private labels)</li> </ul>                    |
| Lura.2       | <ul style="list-style-type: none"> <li>• Consolidation of three companies into one</li> <li>• Soft downsizing</li> <li>• Focus on cost improvements through restructuring projects</li> <li>• Centralization</li> <li>• Reorganization into functional organization</li> <li>• Focus on domestic sales and distribution with existing products</li> </ul>                                                                                            |
| Podravka.2   | <ul style="list-style-type: none"> <li>• Some spin-offs of non-core activities</li> <li>• Soft downsizing</li> <li>• Centralization</li> <li>• Reorganization along unclear lines</li> <li>• Focus on sales and distribution in core markets</li> </ul>                                                                                                                                                                                              |

Table 6.11 Observed organizational template characteristics in defensive restructuring cycles (continued)

It is obvious that all seven cycles share most characteristics of the new organizational templates. According to the predictions of the research model, asset restructuring was used in all cases except one (Lek.1). However, the observations from the field study indicate that the primary motive for its use was not to achieve one-off financial gains to serve as part of financial consolidation or balance sheet improvements, as would be suggested by the theory. In the cases observed asset restructuring was primarily used as part of a focus on core activities and a shedding of unsustainable lines of business, and therefore also served as a form of downsizing.

All seven cycles included downsizing, although of different intensities, confirming the predictions of the research model. It is interesting to note, though, that in only two cases was a “hard” approach to downsizing used: in one case layoffs via divisional bankruptcies (Končar.1) and in the other the mechanism of technological surpluses (Kolinska.1). In both

cases aggressive downsizing had negative side effects, primarily in the form of fear and declining trust.

Other forms of cost-cutting were present in all of the successful defensive restructuring cycles. Actually, the most successful (Gorenje.1, Lek.1, LM.3, Lura.2) included systematic projects aimed at cost-cutting through process improvement. This led not only to cost reduction, but also to the improvement of the cost structure. Systematic cost-cutting was less pronounced in one cycle, which also resulted in the least convincing improvements (Kolinska.1), and it was practically absent in the two which were labeled as failures (Končar.1, Podravka.2).

As predicted by the research model, centralization was also heavily used. Major centralization was observed in all cases except one (Končar.1), where only a few areas were centralized, including liquidity management and the appointing of divisional managers. It is worth noting that this particular change cycle was unsuccessful.

The final element of the defensive restructuring organizational template according to the research model was a focus on local specifics, rather than a global perspective. While this prediction was to a large degree confirmed by the field study, its observations can also be interpreted in a way linking that statement to the one concerning lack of organizational learning (another observation from the study). The two can serve to explain an observation from all seven cases: none of the companies observed made significant changes to their business models (the way they compete) during defensive restructuring, regardless of all other changes. Almost all increased their focus on (existing) core products and markets, using existing competences. The only attempt to generate major change was observed in Kolinska.1, where the company tried to enter new Central European markets, but the attempt failed and was abandoned.

One element of the new organizational template which was not explicitly predicted by the research model but was observed in all cases except Kolinska.1 was the use of reorganization. In the more successful cases the motivation for reorganization was clear: to achieve better transparency of performance and greater focus on the core business. In both cases perceived as failures, reorganization was carried out without a clear business rationale: in one of them (Končar.1) it was driven by financial and legal considerations, which actually decreased the business viability of the newly-created units by making them smaller and destroying potential synergies; while in the other (Podravka.2) it was primarily driven by political and personal interests, which kept one of the newly-created divisions (food) as a non-transparent conglomerate and created an unhealthy situation in which divisional managers were simultaneously members of the management board.

#### 6.4.2 Key resources in defensive restructuring

Table 6.12 presents a summary of the key resources observed in the seven defensive restructuring cycles.

| Change cycle | Observed key resources                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.1    | <ul style="list-style-type: none"> <li>• Excellent relationship with government, banks and local community</li> <li>• Use of ownership certificates to decrease financial pressure</li> <li>• Secured financial infusion towards the end of the cycle</li> <li>• New accounting system</li> <li>• Technically competent and committed employees</li> <li>• Trust in Stanič</li> <li>• Distribution network in Western Europe</li> </ul>                   |
| Kolinska.1   | <ul style="list-style-type: none"> <li>• Minimal financial reserves</li> <li>• Good long-term relations with licensing partners</li> <li>• Very solid planning and control system</li> <li>• Cooperative unions trusted Deželak, especially in the initial part of the cycle</li> <li>• Solid manufacturing competence</li> <li>• Distribution capabilities in Slovenia</li> </ul>                                                                        |
| Končar.1     | <ul style="list-style-type: none"> <li>• Good relations with local political elite and state-owned customers</li> <li>• Basic technical competence of employees</li> <li>• Some entrepreneurial divisional managers</li> </ul>                                                                                                                                                                                                                            |
| Lek.1        | <ul style="list-style-type: none"> <li>• Solid level of financial slack</li> <li>• Good relations with local market regulators</li> <li>• Strategic planning system</li> <li>• Ability to achieve fast execution</li> <li>• Employees with solid technical competence</li> <li>• Brand and basic sales network in CEE</li> <li>• Trust in Dragonja</li> </ul>                                                                                             |
| LM.3         | <ul style="list-style-type: none"> <li>• Solid level of financial slack</li> <li>• Detailed operational planning and reporting</li> <li>• Solid level of manufacturing and logistics competence</li> <li>• Relatively solid brand position in Slovenia and countries of former Yugoslavia</li> <li>• Very good sales and distribution network in Slovenia</li> <li>• Vehovec as a non-autocratic leader, well-accepted new top management team</li> </ul> |
| Lura.2       | <ul style="list-style-type: none"> <li>• Solid level of financial slack</li> <li>• Solid brands, excellent sales and distribution network in Croatia</li> <li>• Raić as trusted leader, Vukina and his team with excellent track record from companies with high reputation</li> </ul>                                                                                                                                                                    |
| Podravka.2   | <ul style="list-style-type: none"> <li>• Financial injection from EBRD</li> <li>• Excellent regional brand (Vegeta), solid other local brands</li> <li>• Relatively solid sales and distribution network in Croatia</li> <li>• Relatively solid technological competence</li> <li>• Extremely loyal employees</li> </ul>                                                                                                                                  |

Table 6.12 Key resources observed in defensive restructuring cycles

The key resources observed were less homogeneous across the seven cases than the organizational templates. Nevertheless, it is worth noting that for the cases with successful defensive restructuring cycles they come closer to the predictions of the research model.

All the observed companies except Končar.1, Kolinska.1 and the very first part of Gorenje.1 could count on reasonable financial resources allowing them to undergo defensive restructuring without an acute financial crisis. Creative use of ownership certificates allowed for less drastic measures in the case of Gorenje.1, which in turn supported the high level of trust and commitment of employees. In contrast, a lower level of financial slack in Kolinska.1 combined with a relatively weak competitive position led to more aggressive downsizing, which eventually had a negative effect on the trust in leadership.

The next resource predicted by the research model was a controlling system to facilitate transparent performance. This in some form was observed in four cases, but was absent in the two unsuccessful cycles (Končar.1, Podravka.2), which confirms the research model's prediction regarding the elements needed for successful defensive restructuring. An efficient control system was also not seen clearly in Lura.2, this being contrary to the predictions of the research model. One explanation may lie in the specific situation of Raić's position as owner-manager up to 1998, where he had an intimate insight into the performance of individual parts of the company, which, together with relatively high level of financial slack and heavy use of consultants, allowed the company to successfully complete the consolidation phase. However, as illustrated in section 6.5, deficiencies in this area continued to affect the company negatively in the first cycle of strategic restructuring.

The next suggestion from the research model identifies optimal use of human talent (noting in particular scarce middle management) as a key resource. This formulation proved poorly chosen, since it did not provide the field study with a reference to the definition of "optimal" as opposed to sub-optimal. A related factor was observed in the field study, however: the importance of a company's having competent employees, but also other key competences needed for successful implementation of the business model chosen as part of the organizational template. As noted above, all the observed companies chose to continue with the model existing immediately prior to the start of defensive restructuring, with a pronounced focus on core lines of business and core markets. All the companies displayed solid levels of technological competence (clearly a legacy from the past, when emphasis had been placed on manufacturing and access to solid manufacturing technologies was possible). Some companies (in particular in Končar.1 and to some degree in Podravka.2) had problems with sales and distribution competence in core markets, while almost all had difficulties with marketing-related competences, but did not see these as vital in the defensive restructuring cycle.

Finally, the research model's prediction concerning trust in leadership and the company's survival capability is to a large degree matched by the observations of the field study. In both examples of failed change cycles (Končar.1 and Podravka.2) it was clear that the employees lacked trust in top management, while in the case of Končar.1 there was very little trust in the survival of the company, riddled as it was with a wave of divisional bankruptcies. Also, in Kolinska.1 trust in top management had been eroded by aggressive downsizing. In successful cases (Gorenje.1, Lek.1, LM.3, Lura.2) trust was not only clearly present across the spectrum, from frontline employees to top management and back (top managers trusted in the ability of employees to bring the company through the crisis, even though they admitted that competences could be improved), but also between top management and key stakeholders.

#### 6.4.3 Leadership interventions in defensive restructuring

Table 6.13 presents a summary of the leadership interventions observed in the seven defensive restructuring cycles.

| Change cycle | Observed leadership interventions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.1    | <ul style="list-style-type: none"> <li>• Top-down decision making</li> <li>• Focused investments (manufacturing and quality improvements, control system)</li> <li>• Intensive communication with employees (including use of ownership certificates, explicit promises of no layoffs, quality issues)</li> <li>• Intensive communications with banks, local community and political elite</li> <li>• Putting pressure on middle management to achieve planned goals</li> <li>• Indirect use of fear for job to strengthen technological discipline</li> </ul> |
| Kolinska.1   | <ul style="list-style-type: none"> <li>• Top-down decision-making</li> <li>• Intensive communication with unions</li> <li>• Explicit pressure of layoffs to instill discipline and improve productivity</li> </ul>                                                                                                                                                                                                                                                                                                                                             |
| Končar.1     | <ul style="list-style-type: none"> <li>• Limited communication with divisional management</li> <li>• Interventions reduced to appointing / firing of divisional managers</li> </ul>                                                                                                                                                                                                                                                                                                                                                                            |
| Lek.1        | <ul style="list-style-type: none"> <li>• Top-down decision-making</li> <li>• Focused investments (manufacturing and quality improvements, sales and distribution network in CEE, R&amp;D)</li> <li>• Intensive communication with middle management and unions</li> <li>• Tactical use of consultants as change agents in restructuring projects</li> <li>• Putting pressure on middle management to achieve planned goals</li> </ul>                                                                                                                          |
| LM.3         | <ul style="list-style-type: none"> <li>• Top-down decision-making</li> <li>• Intensive communication with middle management, unions and supervisory board</li> <li>• Changes in middle management</li> <li>• Tactical use of consultants as change agents in restructuring projects</li> </ul>                                                                                                                                                                                                                                                                 |
| Lura.2       | <ul style="list-style-type: none"> <li>• Top-down decision-making</li> <li>• Intensive communication with frontline employees</li> <li>• Tactical use of consultants as change agents in restructuring projects</li> </ul>                                                                                                                                                                                                                                                                                                                                     |
| Podravka.2   | <ul style="list-style-type: none"> <li>• Top management dominated by supervisory board</li> <li>• Surprising middle managers with unexpected and conflicting decisions</li> <li>• Bypassing middle management with direct interventions</li> <li>• Tactical use of consultants as change agents in restructuring projects</li> </ul>                                                                                                                                                                                                                           |

Table 6.13 Observed leadership interventions in defensive restructuring cycles

The observed leadership interventions in successful cycles of defensive restructuring (Gorenje.1, Lek.1, LM.3, Lura.2, to some degree Kolinska.1) included all three of the interventions predicted by the research model: top-down decision-making, intensive communication aimed at building trust, and use of coercion to speed up execution and in particular to introduce stricter technological (process) discipline.

The unsuccessful cycles (Končar.1 and Podravka.2) lacked most of the predicted elements. In Končar.1, top management left all the strategic decision-making to divisional managers. At the same time communication between the management board and division managers was significantly limited, while communication between the management board and frontline employees was practically eliminated. In Podravka.2, the top management left most of the strategic decision-making to the supervisory board. Communication with middle management

was poor and the top management often made tactical decisions which directly eroded the authority of middle managers and each other.

Two interventions were observed in addition to those predicted by the research model. The first was intensive communication with other stakeholders, and not only employees or employee representatives (Gorenje.1, Lek.1, LM.3, Lura.2, Podravka.2). This was used to justify austerity measures, as well as to secure additional resources or at least buy time for changes.

The second additional intervention, present in the majority of the cases observed (Lek.1, LM.3, Lura.2, Podravka.2), was the use of global consulting companies to support the change process and in particular to serve as a bridge between top and middle management. In all of the observed engagements the consultants were used at a tactical level, primarily to secure cost-cutting and process improvements within the existing business model.

#### 6.4.4 Barriers to change in defensive restructuring

Table 6.14 presents a summary of the major internal barriers to change observed in the seven defensive restructuring cycles.

| Change cycle | Observed major internal barriers to change                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.1    | <ul style="list-style-type: none"> <li>• Poor skills and inappropriate attitudes (e.g. lack of initiative, poor technological discipline leading to low quality)</li> <li>• Fear, especially on the part of middle managers</li> <li>• Loyalty based on lack of mobility</li> </ul>                                                                                                                                                                                          |
| Kolinska.1   | <ul style="list-style-type: none"> <li>• High cost of downsizing</li> <li>• Fear, especially on the part of frontline employees</li> <li>• Lack of resources and strategic competences</li> <li>• Limited number of high-potential middle managers and professionals</li> <li>• Loyalty based on lack of mobility</li> </ul>                                                                                                                                                 |
| Končar.1     | <ul style="list-style-type: none"> <li>• Strategic uncertainty and lack of trust in future</li> <li>• Frustration and feeling of helplessness among employees and middle managers</li> <li>• Complete lack of resources</li> <li>• Significant lack of not-technical competences</li> <li>• Weak divisional and middle management</li> <li>• Poor transparency of results</li> <li>• Lack of trust in top management</li> <li>• Loyalty based on lack of mobility</li> </ul> |
| Lek.1        | <ul style="list-style-type: none"> <li>• Limited resources</li> <li>• Improvable non-technical competence</li> <li>• Fear for job among frontline employees</li> <li>• Fear of incompetence among middle management</li> </ul>                                                                                                                                                                                                                                               |

Table 6.14 Observed major internal barriers to change in defensive restructuring cycles

| Change cycle | Observed major internal barriers to change                                                                                                                                                                                                                                                                                                                                                                                       |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| LM.3         | <ul style="list-style-type: none"> <li>• Poor non-technical competence</li> <li>• Lack of initiative among middle managers and frontline employees</li> <li>• Limited number of high potential middle managers and professionals, passive or negative “old guard”</li> <li>• Fear for job among frontline employees</li> <li>• Fear of incompetence among middle management</li> </ul>                                           |
| Lura.2       | <ul style="list-style-type: none"> <li>• Poor non-technical competence</li> <li>• Lack of initiative among middle managers and frontline employees</li> <li>• Limited number of high potential middle managers and professionals</li> <li>• Fear for job among frontline employees</li> <li>• Fear of incompetence among middle management</li> <li>• Loyalty based on lack of mobility</li> </ul>                               |
| Podravka.2   | <ul style="list-style-type: none"> <li>• Frustration and feeling of helplessness among employees and middle managers</li> <li>• Claims of non-ethical behavior and lack of trust in top management</li> <li>• Lack of competence, commitment and alignment among top managers</li> <li>• Significant lack of non-technical competence</li> <li>• Fear for job / position</li> <li>• Loyalty based on lack of mobility</li> </ul> |

Table 6.14 Observed major internal barriers to change in defensive restructuring cycles (continued)

The first of the barriers predicted by the research model was strategic uncertainty. The only cycle in which this barrier was clearly observed was Končar.1; and the quality of the various strategic scenarios prepared in several companies (Kolinska.1, Lek.1, LM.3) shows that management could understand complex and swift changes as well as act despite uncertainty. Therefore it is reasonable to assume that this research model prediction is wrong, provided that the top management has a reasonable understanding of its business and trusts in the future of the company.

Problems with skills and attitudes, or in more general terms with various competences, were present in all the observed cases as predicted by the research model. In particular, companies had difficulties with legacies from the past: lack of initiative-taking (additionally influenced in Slovenia and some parts of Croatia by the national or regional culture) and poor market-related and line management competences.

Fear was also a well-predicted barrier. In some cases it applied to frontline employees afraid of layoffs, even when soft downsizing was applied by the company. In extreme cases (Končar.1, Podravka.2) fear was combined with feelings of denial, frustration and helplessness, as predicted in the literature for situations of deep stress and unethical behavior. Another type of fear observed in all cases and present among middle managers involved possible incompetence in new circumstances leading to potential loss of position. This fear was obviously magnified because of increased pressure on middle management performance and was stronger among older managers.

Loyalty based on lack of mobility was present in almost all cases. This presented a major problem since it reinforced weak employee structures and often distorted perceptions held by



top managers as to the commitment and quality of their workforce. It is not surprising that most top managers quoted loyal employees as an advantage, while at the same time pointing out problems with poor skills and attitudes. This group of employees was also the most vocal in pointing out the need to support the interests of the local community, this statement constituting an effective barrier to change.

Finally, another major barrier not clearly predicted by the research model was insufficient resources for investment in competence building. This problem is related to a lack of organizational learning and a lack of understanding as to which competences are critical, plus no clear commitment from the top to build them even to the extent possible with limited resources. These problems were most clearly present in the change cycles with poor or below-average results (Kolinska.1, Končar.1, Podravka.2). In successful change cycles some learning was observed, but was limited almost exclusively to “routine” process improvements related to the existing business model.

## **6.5 Characteristics of strategic restructuring**

The fifth research question focused on the nature and characteristics of strategic restructuring:

Q5. Where strategic restructuring was one of the responses, what was its nature? What were the key elements of the new organizational template? What were the key resources needed? What were the main leadership interventions used during implementation, and the barriers to successful implementation of the new template?

Of the ten strategic restructuring change cycles observed, two (Gorenje.4, LM.4) have undergone the trigger phase only very recently and are still in the design phase. As noted in 6.3, although not all elements of the design are clear, there are several early indications of the nature of these phases. Some main design elements are already clear, as well as the resources deployed, as are the initial leadership interventions and barriers. Therefore both cycles have been included in the analysis presented below.

Four more strategic restructuring change cycles (Končar.3, Lek.4, Lura.4, Podravka.4) are still to be completed, although three of these have already lasted for four years. Final conclusions are not yet possible, but all four seem to be successful in term of obvious improvements in company strategic position, competitiveness, and financial results.

Of the four concluded strategic restructuring cycles, three (Gorenje.2, Gorenje.3, Lek.2) led to improvements in competitiveness and were regarded by top management as successful, while one (Lura.3) was seen as only partially successful and led to the replacement of the top management team, a revision of company strategy, and other changes.

### **6.5.1 Organizational templates in strategic restructuring**

Table 6.15 presents a summary of the organizational template characteristics observed in the ten strategic restructuring cycles.

| <b>Change cycle</b> | <b>Observed organizational template characteristics</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|---------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.2           | <ul style="list-style-type: none"> <li>• Focus on extending from lower to mid-price range in existing markets</li> <li>• Focus on achieving growth through a balance between the company's own and private labels</li> <li>• Improvements in production processes leading to cost-cutting</li> <li>• Focus on new product development with higher added value</li> <li>• Intensive technical education</li> <li>• Use of benchmarking and global consultants to improve processes</li> </ul>                                                       |
| Gorenje.3           | <ul style="list-style-type: none"> <li>• Continued attempt to stretch the offering and move towards a higher price range, but remaining fast follower</li> <li>• Pan-European market player</li> <li>• Opportunistic strategy within individual markets</li> <li>• Diversification to use brand potential</li> <li>• Focus on design, user-friendly products, and sales and distribution flexibility as factors of differentiation</li> <li>• Global benchmarking</li> <li>• Decentralization</li> <li>• Education of middle management</li> </ul> |
| Gorenje.4           | <ul style="list-style-type: none"> <li>• Focus on growth (including acquisitions), primarily in core business</li> <li>• Combined focus on Europe and North America</li> <li>• Focus on improving financial performance</li> <li>• Brand consolidation across markets</li> </ul>                                                                                                                                                                                                                                                                   |
| Končar.3            | <ul style="list-style-type: none"> <li>• Clear statement on strategic positioning and differentiation factors</li> <li>• Focus on Central and South East Europe</li> <li>• Use of synergies</li> <li>• Focus on low cost</li> <li>• Focus on flexible, middle to high (but not state-of-the-art) technology and single unit or small batch products</li> <li>• Benchmarking and learning through dummy tendering procedures</li> <li>• Reorganization</li> </ul>                                                                                   |
| Lek.2               | <ul style="list-style-type: none"> <li>• Clear statement on strategic positioning and differentiation factors based on thorough review of global industry trends</li> <li>• Focus on growth in core business</li> <li>• Focus on Central and East European branded generics market</li> <li>• Key processes: manufacturing, new product development and registration, time to market, sales and distribution in CEE</li> <li>• Systematic professional education at all levels</li> </ul>                                                          |
| Lek.4               | <ul style="list-style-type: none"> <li>• Clear statement on strategic positioning and differentiation factors based on thorough review of global industry trends</li> <li>• Global focus</li> <li>• Systematic competence building</li> <li>• Learning from integration with Sandoz</li> </ul>                                                                                                                                                                                                                                                     |
| LM.4                | <ul style="list-style-type: none"> <li>• Focus on regional expansion, but mode of execution still undefined</li> <li>• Focus on new product development, brand consolidation, new ERP system</li> <li>• Benchmarking (especially with Austrian dairies undergoing similar experience), learning from consultants, systematic executive education</li> </ul>                                                                                                                                                                                        |

Table 6.15 Observed organizational template characteristics in strategic restructuring cycles

| Change cycle | Observed organizational template characteristics                                                                                                                                                                                                                                                                                                                                                                                            |
|--------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Lura.3       | <ul style="list-style-type: none"> <li>• Focus shifting from regional expansion to local diversification to strategic partnership</li> <li>• Focus on process optimization and new product development</li> <li>• Use of global consultants for process optimization</li> <li>• Centralization</li> </ul>                                                                                                                                   |
| Lura.4       | <ul style="list-style-type: none"> <li>• Focus on organic growth and growth through acquisitions, diversifications in local market and core business in Central and South East Europe</li> <li>• Focus on process improvements, new product development, marketing and brand consolidation</li> <li>• Learning from benchmarking and global consultants</li> <li>• Systematic professional education</li> <li>• Decentralization</li> </ul> |
| Podravka.4   | <ul style="list-style-type: none"> <li>• Clear strategic positioning (high quality, local taste, brand)</li> <li>• Focus on organic growth and growth through acquisitions</li> <li>• Focus on new product development, marketing and brand extensions, sales and distribution</li> <li>• Decentralization, reorganization along business lines</li> <li>• Benchmarking</li> <li>• Learning from strategic partners</li> </ul>              |

Table 6.15 Observed organizational template characteristics in strategic restructuring cycles (continued)

The research model predicts that companies which are successful in their strategic restructuring attempts should clearly define their strategic positions and sources of competitive advantage. In the companies observed, clear positioning and explicit identification of sources of competitive advantage were observed in five out of eight completed cycles (Gorenje.2, Končar.3, Lek.2, Lek.4, Podravka.4). Only in Lura.3 did the company in question lack a clear statement on strategic positioning: it altered it three times during the cycle, then changed its top team and defined its strategy more consistently. In other cases it is either too early to say (Gorenje.4, LM.4) or statements were only partially clear or somewhat inconsistent (Gorenje.3, Lura.4).

The next prediction from the research model is the ability of successful companies to focus on building critical competences. Observations from the field study seem to confirm that this was indeed part of strategic restructuring. A clear focus on building the competences identified as the most important for improved competitiveness was observed in seven cycles (Gorenje.2, Končar.3, Lek.2, Lek.4, LM.4, Lura.4, Podravka.4). While it is too early to make a qualified statement for the cycle Gorenje.4, it seems that in cycles Gorenje.3 and Lura.3 this focus was somewhat less clear than in the others. These two also lacked clear strategic statements, this being the most probable reason for the effect, as indicated in interviews with the top and middle managers participating in those cycles.

The final prediction from the research model concerns the significant presence of organizational learning, and global rather than local sources of learning. This prediction seems to be confirmed by observations in virtually all the strategic restructuring cycles, with the exception of Lura.3 where the learning effects were somewhat diminished by an

intimidating leadership style and lack of strategic clarity. The most common sources of learning were benchmarking exercises targeting global or regional competitors (with particular focus on Western European companies of similar size and profile, as observed in the cases of Gorenje.3, Gorenje.4, Končar.3, Lek.2, Lek.4, LM.4, Lura.4 and Podravka.4). Formal management and other professional education programs including exposure to international experience were also used heavily, as was systematic cooperation with global management consulting companies. It is interesting to note, however, that the use of consultants, while indicating a readiness on the part of the companies observed to seek and accept recommendations based on global best practices, was still confined to process improvements. In several cases top management explicitly stated that the company, rather than the consultants, must define answers to strategic issues (Lek.4, Lura.4, Podravka.4).

Finally, one organizational template characteristic which was only implied by the research model was observed in several strategic restructuring cycles. The research model predicted a balancing of top-down and bottom-up change initiatives, instead of a strictly top-down defensive restructuring mode. One possible related effect to be expected as part of the organizational template is more decentralization. The observations from the field study are interesting, although they come from a very small sample. While a clear trend towards decentralization was observed in Gorenje.2, Gorenje.3, Lura.4 and Podravka.4, and in the initial signals from LM.4, the trend is less clear in Gorenje.4 and is obviously the opposite in Končar.3. This may be because the balance in the two cases leaned the “wrong way” (i.e. towards too much decentralization) in the past, this very clear in Končar.3 and indicated in interviews concerning Gorenje.4. At the same time Lura.3 stands out as an example of an inappropriate organizational template where no decentralization at all was detected in a heavily centralized environment. This seems to have had negative effects on the change outcome and was confirmed through interviews as one of the major obstacles to change.

#### 6.5.2 Key resources in strategic restructuring

Table 6.16 presents a summary of the key resources observed in the ten strategic restructuring cycles.

| Change cycle | Observed key resources                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.2    | <ul style="list-style-type: none"> <li>• (Limited) financial resources</li> <li>• Solid management accounting system</li> <li>• Technically-competent and loyal employees</li> <li>• Commitment to improvements</li> <li>• Trust in Stanič</li> <li>• Distribution network in Western Europe</li> <li>• “Value for money” products</li> </ul>                                                                                                                                                       |
| Gorenje.3    | <ul style="list-style-type: none"> <li>• (Limited) financial resources</li> <li>• Solid management accounting system</li> <li>• Technically- competent and loyal employees</li> <li>• Commitment to improvements</li> <li>• Trust in Stanič</li> <li>• Flexible but not state-of-the-art production</li> <li>• Distribution network throughout Europe</li> <li>• Wide range of products, some with high-end user-friendliness / design</li> <li>• Patient and friendly supervisory board</li> </ul> |

Table 6.16 Observed key resources in strategic restructuring cycles

| <b>Change cycle</b> | <b>Observed key resources</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|---------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.4           | <ul style="list-style-type: none"> <li>• Initially same as Gorenje.3, except that Bobinac replaced Stanič and was seen by employees as a leader respecting continuity</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                        |
| Končar.3            | <ul style="list-style-type: none"> <li>• Solid controlling system</li> <li>• Technical competence</li> <li>• Regional brand</li> <li>• Low cost</li> <li>• Good relations and understanding of key customers</li> <li>• Bago commands respect and is trusted by key stakeholders</li> <li>• Patient and friendly supervisory board</li> </ul>                                                                                                                                                                                                                           |
| Lek.2               | <ul style="list-style-type: none"> <li>• Solid level of financial resources</li> <li>• Good relations with local market regulators</li> <li>• Strategic planning system</li> <li>• Ability to achieve rapid execution through project management</li> <li>• Employees with solid technical competence</li> <li>• Brand and basic sales network in CEE</li> <li>• Trust in Dragonja</li> </ul>                                                                                                                                                                           |
| Lek.4               | <ul style="list-style-type: none"> <li>• Solid level of financial resources</li> <li>• Strategic planning and risk management system</li> <li>• Ability to achieve rapid execution through project management</li> <li>• Employees with solid technical competence</li> <li>• Brand and excellent sales and distribution network in CEE</li> <li>• Solid R&amp;D competence</li> <li>• Wide product portfolio, some products with high global potential</li> <li>• Trust in Dragonja</li> <li>• Supportive supervisory board and long-term strategic partner</li> </ul> |
| LM.4                | <ul style="list-style-type: none"> <li>• Solid level of financial resources</li> <li>• Solid strategic planning system</li> <li>• Detailed operational planning and reporting</li> <li>• Solid level of manufacturing and logistics competence</li> <li>• Very good sales and distribution network in Slovenia</li> <li>• Trust in Vehovec</li> </ul>                                                                                                                                                                                                                   |
| Lura.3              | <ul style="list-style-type: none"> <li>• Solid level of financial resources</li> <li>• Solid reporting system</li> <li>• Solid level of technological competence</li> <li>• Solid brands, excellent sales and distribution network in Croatia</li> </ul>                                                                                                                                                                                                                                                                                                                |
| Lura.4              | <ul style="list-style-type: none"> <li>• Solid level of financial resources</li> <li>• Very good planning and reporting system</li> <li>• Solid level of technological competence</li> <li>• Improved market- related competence in Croatia, Bosnia and Herzegovina and Slovenia</li> <li>• Very good processes related to new product development</li> <li>• Trust in Perić and his team</li> <li>• Supportive owner</li> </ul>                                                                                                                                        |

Table 6.16 Observed key resources in strategic restructuring cycles (continued)

| Change cycle | Observed key resources                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Podravka.4   | <ul style="list-style-type: none"> <li>• Some financial resources</li> <li>• Excellent transparency of results for all business lines</li> <li>• Solid level of technological competence</li> <li>• Improved market-related competence throughout Central and South East Europe</li> <li>• Improved new product development processes</li> <li>• Excellent HR systems at the executive level</li> <li>• Trust in Marinac and his team</li> <li>• Supportive supervisory board</li> </ul> |

Table 6.16 Observed key resources in strategic restructuring cycles (continued)

The observations from the field study confirm the first two predictions of the research model. In all the observed strategic restructuring cycles companies managed to amass some financial resources committed to restructuring, typically in the form of investment in selected competences. The only exception was to some degree Končar.3, where financial resources were not fully centralized but mostly generated and held at divisional level. However, better alignment of investment and increased centralization of resources were observed. At the same time, good to excellent transparency of results was achieved by all the companies observed.

The third prediction from the research model concerns optimal use of human resources. As discussed in 6.5.2, the definition of this resource is poor and should be substituted by “sufficiency of competences needed for the implementation of the chosen business model”. Matching the observations from the field study with the modified formulation of the prediction from the research model yields interesting results. As noted in 6.5.1, in all cases except Gorenje.3 and Lura.3 companies focused on building critical competence. Indeed, one can observe a clear improvement in the level of non-technical competence, in particular in relation to markets and customer intimacy (this falls in line with the sixth prediction of the research model).

Trust in leadership, and certain leadership interventions, were another two critical resources suggested by the research model. Together with lack of strategic clarity, these two were further factors missing in the case of Lura.3, which is the only cycle where no significant level of trust in top management was observed and the only one in which leadership did not intervene as predicted (as described in 6.5.3). Since Lura.3 featured as the only unsuccessful change cycle, its unique combination of missing factors deserves special attention.

The next three critical resources predicted by the research model differentiate the resources needed in strategic from those needed in defensive restructuring. The first of these is flexible reaction to changes, in particular rapid new product development. This factor was clearly observed in nine out of ten cycles, the partial exception being Končar.3, where a clear focus on new product development was observed only in the best divisions. Possible explanations for this are an uneven level of restructuring across divisions linked with scarce financial and leadership resources in some, the mature nature of the industry, and its long technological cycles.

Flexibility of reaction in some of the cases observed deserves additional comment. In the case of Gorenje, it was observed that the company changed course and repositioned itself with

respect to competition. It is also relatively clear that in the third change cycle (Gorenje.3) Gorenje lost its clarity of positioning while reacting to opportunities. The same is true for cycle Lura.3, where the company was “too flexible”. Thus, overly opportunistic behavior again proved to be potentially disruptive, as also indicated in the analysis of the trigger phase (see 6.2.2). However, while in Gorenje.3 this was compensated by strong leadership and the phase was successfully completed, in Lura.3 the leadership was unable to compensate for the weakness.

The next research model prediction concerned stakeholder intimacy. While this is partially covered in the discussion of employee trust and market-related competences above, other important stakeholders requiring mention include the local community, suppliers and (above all) owners. In all of the observed cases there were good to excellent relations with the local community, despite potential problems (e.g. in Lek.4 with acquisition by a foreign strategic partner, or in Podravka.4 with a new general manager from outside the local community). Relations with suppliers ranged from tense (e.g. Gorenje.4, LM.4) to excellent (e.g. Lek.4, Podravka.4), but in all cases companies displayed a good understanding of their suppliers and careful supply chain management. Relations with owners were in eight out of ten cycles excellent, giving the management the needed clout to push for changes. The exception was the second part of Lura.3, where the majority owner became impatient and finally removed the top management team. Another potential problem may be observed in LM.4 in the conflicting interests of major groups of owners, which may jeopardize strategic restructuring in the future.

Finally, the question of time as the last critical resource suggested by the research model remains only partially answered by the field study, since six out of ten cycles have not yet been completed and two are in the initial phase. In the remaining four cycles, management has already spent from one to four years on this. Of the four completed cycles it is clear that in the one marked as unsuccessful the owner refused the management team further time, while in the three successfully completed cycles management had from three to six years to make changes. As noted in 6.3, strategic restructuring seems to require substantial time, which by default becomes a prerequisite for its success.

### 6.5.3 Leadership interventions in strategic restructuring

Table 6.17 presents a summary of the leadership interventions observed in the ten strategic restructuring cycles.

| Change cycle | Observed leadership interventions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.2    | <ul style="list-style-type: none"> <li>• All key elements of the organizational template designed at the top</li> <li>• Strategic positioning clearly communicated to middle management</li> <li>• Strong hierarchy but heavy involvement of top 50 managers in leading change</li> <li>• Intensive direct communication with frontline employees</li> <li>• Putting pressure on middle management (including demotions) to achieve planned goals</li> <li>• Using consultants for achieving process improvements and as source of learning about European best practices</li> </ul> |

Table 6.17 Observed leadership interventions in strategic restructuring cycles

| <b>Change cycle</b> | <b>Observed leadership interventions</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|---------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.3           | <ul style="list-style-type: none"> <li>• Key elements of the organizational template designed at the top, but with heavy involvement of senior management</li> <li>• Intensive direct communication with frontline employees and all major stakeholders</li> <li>• Putting pressure on middle management (including demotions) to achieve planned goals</li> <li>• Opportunities for young managers and initiative-taking</li> <li>• Using consultants for achieving process improvements and as source of learning about European best practices</li> </ul>                                                                                         |
| Gorenje.4           | <ul style="list-style-type: none"> <li>• Significant rejuvenation of top management team, departure from philosophy of internal promotion</li> <li>• All key elements of the organizational template designed at the top</li> <li>• New set of strategic goals clearly communicated to middle management</li> <li>• Promoting values of international culture</li> <li>• Combining challenge and material stimulation</li> <li>• Using consultants as agents of change and source of learning about global best practices</li> </ul>                                                                                                                 |
| Končar.3            | <ul style="list-style-type: none"> <li>• Replacing top management team</li> <li>• All key elements of the organizational template designed at the top</li> <li>• Top management team decides by consensus</li> <li>• New set of strategic goals clearly communicated to divisional management</li> <li>• Intensive direct communication with all major stakeholders</li> <li>• Putting pressure on divisional management (including demotions) to achieve alignment with corporate goals and change the way they work</li> <li>• Using consultants as agents of change and source of learning about global best practices</li> </ul>                 |
| Lek.2               | <ul style="list-style-type: none"> <li>• All key elements of the organizational template designed at the top</li> <li>• Top management team in principle decides by consensus</li> <li>• Strategic goals communicated to middle management</li> <li>• Putting pressure on middle management (including loss of position but with compensation) to achieve planned goals and change the way they work</li> <li>• Stimulating initiative-taking through projects</li> <li>• Hiring, developing and giving opportunities to young talent</li> <li>• Using consultants as agents of change and source of learning about global best practices</li> </ul> |

Table 6.17 Observed leadership interventions in strategic restructuring cycles (continued)



| Change cycle | Observed leadership interventions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Lek.4        | <ul style="list-style-type: none"> <li>• All key elements of the organizational template designed at the top</li> <li>• Top management team decides by consensus</li> <li>• Strategic goals communicated to middle management</li> <li>• Putting pressure on middle management (including loss of position but with compensation) to achieve planned goals and change the way they work</li> <li>• Stimulating initiative-taking through projects</li> <li>• Hiring, developing and giving opportunities to young talent</li> <li>• Intensive communication with all stakeholders about the benefits of strategic partnership and the acceptability of acquisition</li> <li>• Using consultants as source of learning about global best practices</li> </ul> |
| LM.4         | <ul style="list-style-type: none"> <li>• Top-down decision making</li> <li>• Top management team decides by consensus</li> <li>• Involvement of middle managers through improvement projects</li> <li>• Putting pressure on middle management (including demotions) to achieve planned goals and change the way they work</li> <li>• Hiring and developing young talent (although with mixed results)</li> <li>• Intensive communication with key stakeholders, in particular the supervisory board</li> <li>• Building trust through “winning” well-selected conflicts with some key stakeholders</li> <li>• Using consultants as change agents, for achieving process improvements and as source of learning about European best practices</li> </ul>      |
| Lura.3       | <ul style="list-style-type: none"> <li>• Strictly top-down decision making (including tactical level)</li> <li>• Putting pressure on middle management (including demotions) to achieve planned goals</li> <li>• Hiring and developing young talent</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| Lura.4       | <ul style="list-style-type: none"> <li>• Key elements of the organizational template designed at the top, but with heavy involvement of senior management</li> <li>• Top management team decides by consensus</li> <li>• Intensive communication with middle management, clear indication of vision and strategic goals</li> <li>• Putting pressure on middle management (including demotions) to achieve planned goals and change the way they work</li> <li>• Hiring and developing young talent combined with hiring experienced international managers</li> <li>• Using consultants to achieve process improvements and as source of learning about European best practices</li> </ul>                                                                   |

Table 6.17 Observed leadership interventions in strategic restructuring cycles (continued)

| Change cycle | Observed leadership interventions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Podravka.4   | <ul style="list-style-type: none"> <li>• Key elements of the organizational template designed at the top, but with heavy involvement of senior management</li> <li>• Top management team decides by consensus</li> <li>• Intensive communication with middle management, clear indication of vision and strategic goals</li> <li>• Putting pressure on middle management (including demotions) to achieve planned goals and change the way they work</li> <li>• Hiring and developing young talent</li> <li>• Using consultants to achieve process improvements and as source of learning about European best practices</li> </ul> |

Table 6.17 Observed leadership interventions in strategic restructuring cycles (continued)

The most frequently observed characteristic of leadership interventions, present in all change cycles, was a heavy inclination towards top-down decision-making, which accords with the prediction of the research model. As an interesting specific, decision-making at the top was in many cases (Končar.3, Lek.4, LM.4, Lura.4, Podravka.4, to a large degree Gorenje.3 and Lek.2) based on consensus. This was seen as highly important and worth sacrificing speed for. The other part of the prediction was that this should be balanced by bottom-up change management. This was only partially confirmed by the field study, however, since it was clearly present only in Gorenje.3 and Lura.4, and to some degree in Lek.2, Lek.4, LM.4 and Podravka.4.

Similarly, communication patterns indicate a clear top-down dominance, with bottom-up communication completely absent in Lura.3 and significantly reduced in Končar.3. Direct bottom-up communication was also reduced in Lek.2, Lek.4 and LM.4, but was to some degree compensated by communication through projects. The emphases of communication were, in practically all cases, strategic goals, trust-building (except in Lura.3 and, so far, Gorenje.4) and communication of elements of the vision, in particular the strategic positioning of the company (except in Gorenje.3 and Lura.3, for reasons described in 6.5.1). It is worth noting that in half of the cycles (Gorenje.3, Končar.3, Lek.4, LM.4, to some degree Podravka.4) top management engaged in heavy communication with a broader group of stakeholders, effectively securing their support for restructuring, in particular for the time needed to make major changes.

The research model predicted that top management would try to build participation to secure rapid implementation of the new organizational template. This was observed in a fairly specific way, not fully in line with traditional views inviting voluntary participation. On the one hand, in practically all cases top management used formalized improvement projects as a vehicle to achieve changes. This was supported by heavy use of external consultants, although their mandate was typically on the tactical level. In not a single case did consultants formulate or make significant contributions to implementing the key elements of the new organizational template. On the other hand, participation was secured through coercion. Not only were the middle managers in all cases expected to realize set business objectives and could expect demotion if they failed to do so, but in many cases (Gorenje.4, Končar.3, Lek.2, Lek.4, LM.4, Lura.4, Podravka.4) they were explicitly expected to change the way they worked. Top management did not show much patience and in most cases reacted within 6 to 18 months.

Finally, in the majority of cases (Gorenje.4, Lek.2, Lek.4, LM.4, Lura.4, Podravka.4) top management made an explicit commitment to changing the culture of the company, primarily by making it more international and by supporting initiative-taking at all levels. To support this goal, the tactic of bringing in young talent, developing it and offering early opportunities to take more responsibility was combined with bringing in experienced international executives.

#### 6.5.4 Barriers to change in strategic restructuring

Table 6.18 presents a summary of the major internal barriers to change observed in the ten strategic restructuring cycles.

| Change cycle | Observed major internal barriers to change                                                                                                                                                                                                                                                                                                                                                       |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gorenje.2    | <ul style="list-style-type: none"> <li>• Limited number of employees with business (rather than technical) orientation</li> <li>• Fear, especially on the part of middle managers</li> <li>• Loyalty based on lack of mobility</li> </ul>                                                                                                                                                        |
| Gorenje.3    | <ul style="list-style-type: none"> <li>• Limited number of high-potential employees</li> <li>• Raising expectations of better reward / career prospects</li> <li>• Fear, especially on the part of middle managers</li> <li>• Overly local culture</li> </ul>                                                                                                                                    |
| Gorenje.4    | <ul style="list-style-type: none"> <li>• Limited number of high-potential employees</li> <li>• Inert culture</li> <li>• Complacency</li> </ul>                                                                                                                                                                                                                                                   |
| Končar.3     | <ul style="list-style-type: none"> <li>• Poor skills</li> <li>• Limited talent pool</li> <li>• Very limited financial resources</li> <li>• Conflict of interest between top and middle management</li> </ul>                                                                                                                                                                                     |
| Lek.2        | <ul style="list-style-type: none"> <li>• Complex competences (e.g. R&amp;D) requiring improvement</li> <li>• Fear of incompetence and poor performance among middle management</li> <li>• Lack of initiative</li> </ul>                                                                                                                                                                          |
| Lek.4        | <ul style="list-style-type: none"> <li>• Change fatigue</li> <li>• Limited initiative and experimentation</li> <li>• Fear of incompetence and poor performance among middle management</li> </ul>                                                                                                                                                                                                |
| LM.4         | <ul style="list-style-type: none"> <li>• Poor non-technical competence</li> <li>• Lack of initiative on the part of middle managers and frontline employees</li> <li>• Small number of high-potential middle managers and professionals</li> <li>• Fear of incompetence on the part of middle management</li> </ul>                                                                              |
| Lura.3       | <ul style="list-style-type: none"> <li>• Poor non-technical competence</li> <li>• Lack of initiative on the part of middle managers and frontline employees</li> <li>• Small number of high-potential middle managers and professionals</li> <li>• Fear of incompetence on the part of middle management</li> <li>• Friction in top management</li> <li>• Poor timing of the strategy</li> </ul> |
| Lura.4       | <ul style="list-style-type: none"> <li>• Lack of initiative on the part of middle managers</li> <li>• Small number of high-potential middle managers and professionals</li> <li>• Young high-potential employees expect too much too soon</li> </ul>                                                                                                                                             |

Table 6.18 Observed major internal barriers to change in strategic restructuring cycles

| Change cycle | Observed major internal barriers to change                                                                                                                                                                                             |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Podravka.4   | <ul style="list-style-type: none"> <li>• Conflict of interest with local community</li> <li>• Lack of initiative on the part of middle managers</li> <li>• Small number of high-potential middle managers and professionals</li> </ul> |

Table 6.18 Observed major internal barriers to change in strategic restructuring cycles (continued)

One clear observation from the field study is an oft-repeated remark by top management about the relatively low level of barriers to change encountered. This is almost paradoxical, since the evidence regarding the speed of change indicates that change required substantial time and that achieved was often less successful than planned or desired. One possible interpretation of this observation may be that in discussing barriers executives ignored factors which they believed inherent to all organizations (e.g. scarcity of high-potential employees).

As in the case of defensive restructuring, the key internal barriers to change seem to involve middle management, primarily in terms of their insufficient competence, lack of an initiative-taking attitude and fear of job loss. Although most of the other barriers suggested by the research model (except strategic uncertainty) were occasionally observed, none was systematically present.

## 6.6 Conclusions and consequences for the research model

The observations from the field study answered all the research questions formulated on the basis of the literature review.

The existence of three phases of strategic change management as proposed in the research model and presented in Figure 3.11 was confirmed by the observations.

All trigger phases included a number of events that created a cumulative perception of the need for and feasibility of change. In each case, once the management assessed either (or both) of these factors as great enough, it moved to the design stage. The observations from the field study allowed identification of the key factors influencing the assessment, and the direction of their influence, and confirmed most of the predictions made by the research model, while stimulating revision of a few. The revised detailed lists of factors have been presented in Tables 6.9 and 6.10. In summary, the revised groups of factors influencing the assessment are:

1. Issues related to institutional pressures (urgency and feasibility);
2. Financial issues including transparency of performance (urgency);
3. Issues related to industry and market dynamics (feasibility);
4. Issues related to opportunities and growth (urgency);
5. Issues related to resource (competence) availability (feasibility);
6. Issues related to leadership (urgency and feasibility).

In all of the observed cycles the design phases generated deliberate design decisions about the organizational templates to be used, although some of these were neither clear nor consistent enough, or were not well supported by other factors, thus generating failures which in turn served as new triggers. The observations from the field study confirmed that the nature of the design depended on the perceived urgency and feasibility of change (Figure 6.8), as predicted by the research model (Figure 3.13).

In all of the observed cycles management progressed gradually from the design to the implementation phase via various leadership interventions, while relying on certain resources and facing barriers to the implementation of new organizational templates. The observations from the field study allowed identification of the main common characteristics of the organizational templates, key resources, leadership interventions and barriers to change in defensive and strategic restructuring across the studied cases. While the majority of the predictions from the research model were confirmed, some were not confirmed or were revised. A summary of the characteristics of defensive and strategic restructuring proposed by the revised research model are presented in Tables 6.19 and 6.20.

| <b>Dimension</b>           | <b>Characteristics</b>                                                                                                                                                                                                                                                                                                                                                                                                                 |
|----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| • Organizational template  | <ul style="list-style-type: none"> <li>• Asset restructuring used as downsizing tool</li> <li>• Focus on downsizing, soft downsizing gives better results than hard</li> <li>• Focus on various forms of cost-cutting</li> <li>• Centralization</li> <li>• Reorganization to achieve better transparency of performance and focus on core business</li> <li>• No significant change in business model of core business</li> </ul>      |
| • Key resources            | <ul style="list-style-type: none"> <li>• Available financial resources used for restructuring</li> <li>• Efficient control system</li> <li>• Basic competence needed within existing business model, including competent employees</li> <li>• Trust in leader and in survival of the company</li> </ul>                                                                                                                                |
| • Leadership interventions | <ul style="list-style-type: none"> <li>• Top-down decision making</li> <li>• Intensive communication with major stakeholders and in particular employees, aimed at building trust</li> <li>• Use of coercion to speed up execution and introduce process discipline</li> <li>• Use of external consultants to secure cost-cutting and process improvements</li> </ul>                                                                  |
| • Barriers to change       | <ul style="list-style-type: none"> <li>• Poor knowledge, skills and attitudes, in particular those associated with market-related competences and initiative-taking</li> <li>• Fear, in particular of incompetence and layoffs, displayed by middle management</li> <li>• Rigid employee structure</li> <li>• Very limited organizational learning, as well as insufficient resources to be invested in competence building</li> </ul> |

Table 6.19 Characteristics of defensive restructuring

| <b>Dimension</b>           | <b>Characteristics</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|----------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| • Organizational template  | <ul style="list-style-type: none"> <li>• Clear definition of strategic position and sources of competitive advantage</li> <li>• Focus on building critical competences</li> <li>• Organizational learning from global sources</li> <li>• (Appropriate level of) Decentralization</li> </ul>                                                                                                                                                                                           |
| • Key resources            | <ul style="list-style-type: none"> <li>• Financial resources committed to restructuring, in particular competence-building</li> <li>• Focus on market- and customer-intimacy-related competences</li> <li>• Trust in leader</li> <li>• Flexible reaction to changes and in particular new product development</li> <li>• Avoidance of opportunistic behavior</li> <li>• Active stakeholder relationship management</li> <li>• Substantial time available for restructuring</li> </ul> |
| • Leadership interventions | <ul style="list-style-type: none"> <li>• Top-down decision making</li> <li>• Top-down communication focused on strategic positioning and trust-building</li> <li>• Use of external consultants and formal improvement projects to build bottom-up support for change</li> <li>• Pressure on middle management to perform and change the way they work</li> <li>• Commitment to culture change, in particular to becoming more international and initiative-taking</li> </ul>          |
| • Barriers to change       | <ul style="list-style-type: none"> <li>• Lack of competent and initiative-taking middle management</li> <li>• Fear of job loss displayed by middle management</li> </ul>                                                                                                                                                                                                                                                                                                              |

Table 6.20 Characteristics of strategic restructuring

While the duration of individual phases and whole cycles varied, it seems that the implementation phase is on average the longest and the design phase the shortest. Also, it seems that strategic restructuring takes longer on average than defensive restructuring, with the overall duration of turn-around processes exceeding a decade.

## **7. Conclusions**

The final chapter provides a summary of the study's conclusions and in particular addresses its contribution to management theory and practice. To do this, it summarizes the study's answers to the main research question and outlines its limitations, its implications for further research, and its contribution to management theory, as well as considering its implications for practicing managers.

### **7.1 Answers to the main research questions**

The study investigated transformation processes in medium-size companies in Croatia and Slovenia. Although a vital part of the regional economy, these companies have received little attention in management literature. Also, nearly all the literature dealing with transformation processes, which fall under a number of traditional academic categories within the broad disciplines of strategic management and organizational behavior, is based on evidence from large companies in Western Europe and North America and shun an integrative approach, preferring a one-dimensional view of strategic change management confined to a particular academic area.

The objective of the study was to provide an integrative explanation of the transformation processes observed and to support companies in their further transformation efforts. To achieve it, I tried to identify a number of organizational factors which may explain the content and the process of strategic change, relate them to the context in which the change was taking place, and suggest reasons for differences in the outcomes of particular strategic change efforts.

After summarizing the characteristics of the context in which the transformation processes were anchored, I searched for answers to the main research questions via two different avenues. I first performed a thorough review of the relevant literature, both in the area of competitiveness (as change content) and strategic change management (as change process). Based on the literature review I constructed a research model, which I focused on the observations of the subsequent multiple-case field study. These observations, in turn, were used to fine-tune the research model and derive conceptual implications both for management theory and for practicing managers.

#### **7.1.1 Literature review**

The literature review I performed confirmed that the content and the process of strategic change management have rarely been addressed within one piece of research. Also, in many cases the context has been ignored, and theoretical concepts presented as universally valid.

The strong influence of various industrial organization economics theories was noted, as a starting point for considerations of sustainable competitive advantage (defining the change content), while the sciences of psychology and sociology seem to have had the most influence on considerations of strategic change management as a change process.

The review of the literature dealing with sustainable competitive advantage suggests that two possible approaches exist, each possessing certain merits and disadvantages. One approach, with the environmental school as its most established representative, takes the outside-in perspective, looking for sources of competitive advantage through interpretation of the

external environment. The other, with the resource-based view as its dominant representative, takes an inside-out perspective, attributing competitive advantage to internal factors. At the same time, the review of the literature on strategic change brings into focus issues related to the nature of change and integrative change management. It clearly suggests that change should be viewed as a process which evolves in phases.

The literature review covered a fairly wide range of theories, and concepts based on them. Twenty different concepts were identified through the literature review as particularly relevant in the observed context. In one way or another, all provided the foundations upon which the research model was built. Almost paradoxically, the aim of building a reasonably simple research model of strategic change management which would provide an understanding of the observed strategic transformation of companies in Croatia and Slovenia was achieved, despite the fact that it was derived from numerous, often complex concepts and far-reaching underlying theories.

The research model described strategic change as occurring in three phases: trigger, design and implementation, in which feature barriers to change and leadership interventions (Fig. 7.1). It also defined the key elements of individual phases. In the trigger and design phases these comprise the perceived urgency and feasibility of change, which influence not only the decision to initiate change but also the design outcome: the intended organizational template (strategies, systems, structures).

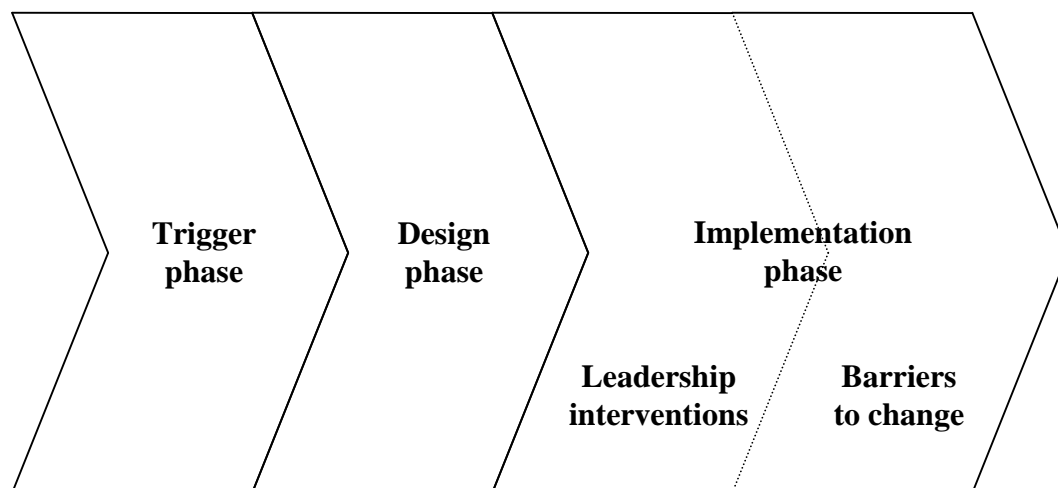


Figure 7.1 Model of strategic change management

The research model established a link between the perceived urgency and feasibility of change on the one hand and the choice of the restructuring approach on the other, with defensive and strategic restructuring identified as alternative forms of restructuring (Fig. 7.2).



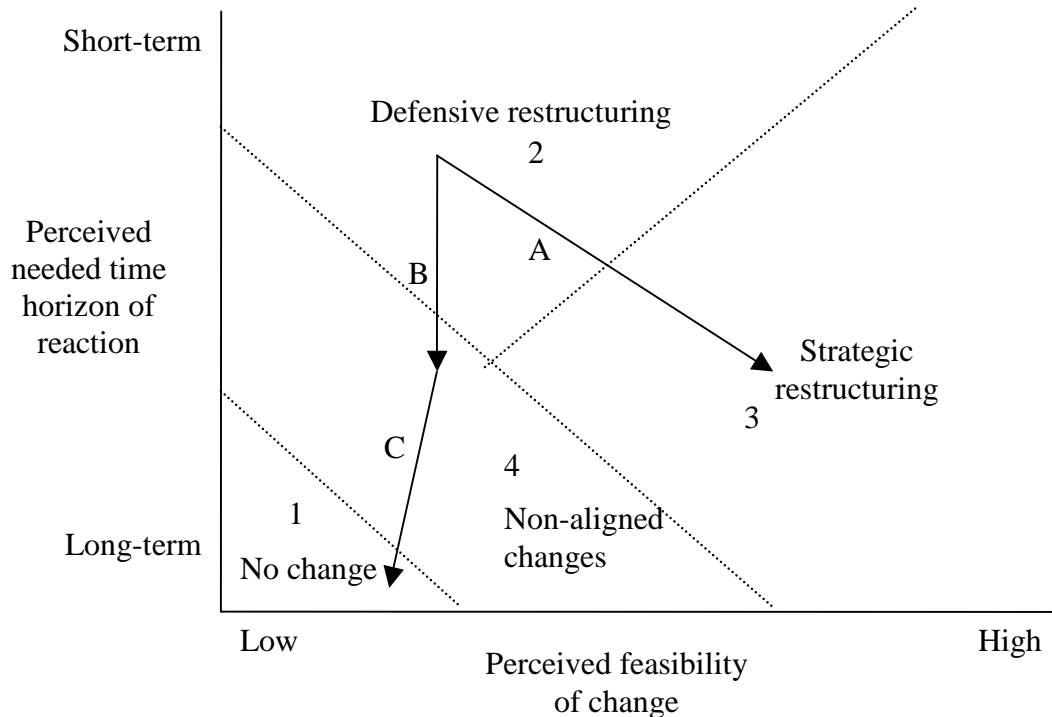


Figure 7.2 Outcomes of the design phase

Finally, the literature review yielded a set of attributes of the defensive and strategic restructuring processes, allowing conceptualization of observations made in the implementation phase, concerning in particular the characteristics of new organizational templates, the critical resources needed for their successful implementation, barriers to change, and leadership interventions.

#### 7.1.2 Field study

The field study was designed to validate the developed concept of three phases of strategic change management through field observations. The decision to use case studies as the most appropriate research form provided a clear framework for all the research activities. Seven manufacturing companies were selected for the field study: Končar, Lura and Podravka from Croatia, and Gorenje, Kolinska, Lek and Ljubljanske mlekarne from Slovenia. These companies were prepared to provide access to all the necessary information and had the potential to be representative and rich enough examples of the phenomena studied. Data and observations were gathered from seven groups of sources, and included the systematic review of media clippings, annual reports, consulting projects prepared for the companies, teaching cases concerning the companies, structured interviews with selected managers, and managerial feedback on the draft research findings. Data and observations focused on the period from 1991 to 2003.

Observations from the field study were analyzed separately for each case and across all seven cases. The findings were refined with the help of an independent expert, who played the role of devil's advocate and challenged the draft conclusions. The refined draft of cases was sent to the companies and feedback from top management was solicited. All seven companies confirmed that the cases truly represented and properly interpreted the period of observation.

Looking back at the field study process, one notes the richness of the observations it provided. The research model proved valuable in systematically interpreting the observations. It allowed identification of 25 distinctive periods of strategic change, or close to 4 periods per company during the 12 years observed. While some of these periods had blurred characteristics and were, following the research model, labeled as non-aligned changes, the majority had characteristics which according to the research model were attributable to defensive or strategic restructuring. This made it possible to base the conclusions on a sample, which despite its smallness provided numerous relevant insights into the nature and mechanisms of the observed change phenomena across all the elements contained in the research model. In this way the field study confirmed the main predictions of the research model, and stimulated some corrections and more precise elaborations on the level of detail.

### 7.1.3 Conclusions

The following are the main conclusions from the field study valid for the companies observed:

- Strategic change in a company begins when top management perceives that change is urgent, or highly feasible, or both. The trigger phase may last for a prolonged period of time and perceptions are formed cumulatively.
- The perception of urgency is based on context interpretation and is in particular driven by:
  - Institutional pressures;
  - Financial situation as seen given the transparency of performance;
  - Growth opportunities;
  - Leadership.
- The perception of feasibility is based on context interpretation and is in particular driven by:
  - Institutional pressures;
  - Industry and market dynamics;
  - Resource (including competences) availability;
  - Leadership.
- Once change has been triggered, top management engages in the design of the new organizational template. The transition from trigger phase to design phase is relatively abrupt.
- Based on the perceived urgency and feasibility of change (see Fig. 7.2), top management decides among the following design choices:
  - No change;
  - A number of changes which are not clearly aligned;
  - Defensive restructuring;
  - Strategic restructuring.
- Defensive and strategic restructuring are choices superior to non-aligned change.
- Key attributes of defensive restructuring are:
  - Organizational template
    - Asset restructuring used as downsizing tool
    - Focus on downsizing, soft downsizing gives better results than hard
    - Focus on various forms of cost-cutting
    - Centralization
    - Reorganization to achieve better transparency of performance and focus on core business
    - No significant change in business model of core business
  - Key resources
    - Available financial resources used for restructuring

- Efficient control system
  - Basic competence needed within existing business model, including competent employees
  - Trust in leader and in survival of the company
- Leadership interventions
  - Top-down decision-making
  - Intensive communication with major stakeholders and in particular employees, aimed at building trust
  - Use of coercion to speed up execution and introduce process discipline
  - Use of external consultants to secure cost-cutting and process improvements
- Barriers to change
  - Poor knowledge, skills and attitudes, in particular those associated with market-related competences and initiative-taking
  - Fear, in particular of incompetence and layoffs, displayed by middle management
  - Rigid employee structure
  - Very limited organizational learning, as well as insufficient resources for investment in competence-building
- Key attributes of strategic restructuring are:
  - Organizational template
    - Clear definition of strategic position and sources of competitive advantage
    - Focus on building critical competences
    - Organizational learning from global sources
    - (Appropriate level of) Decentralization
  - Key resources
    - Financial resources committed to restructuring, in particular competence-building
    - Focus on market- and customer-intimacy-related competences
    - Trust in leader
    - Flexible reaction to changes, in particular new product development
    - Avoidance of opportunistic behavior
    - Active stakeholder relationship management
    - Substantial time available for restructuring
  - Leadership interventions
    - Top-down decision-making
    - Top-down communications focused on strategic positioning and trust-building
    - Use of external consultants and formal improvement projects to support change
    - Pressure on middle management to perform and change the way they work
    - Commitment to culture change, especially to becoming more international and initiative-taking
  - Barriers to change
    - Lack of competent and initiative-taking middle management
    - Fear of losing position displayed by middle management
- The implementation of the new organizational template may start before its design is completed;

- The duration of strategic restructuring is on average longer than that of defensive restructuring and can take several years;
- The success of implementation depends on the consistency of the design as well as on resources and leadership interventions which match the particular design choice.

## 7.2 Limitations of the study and implications for further research

The main limitations of the research study were the consequences of the chosen methodology and the research setting. Although case-study-based research is generally seen as one of the most appropriate methodologies for studying a multidisciplinary research topic of this social-scientific nature, it has shortcomings which need outlining. The purpose of this text is not to repeat the theoretical debates on the validity of case research as a qualitative research method [Miles 1979, Yin 1981, Eisenhardt 1989a, Otley and Berry 1998, Stake 2000], but rather to critically apply to the presented research those arguments which are most frequently raised and had to be considered during the research design. Arguments will be grouped according to the tests presented in Table 4.1.

One of the arguments that sound justified is the proposal that case studies be used to confirm theories not built solely on the ground of theoretical deliberations, but heavily influenced by prior observations. This field study was designed to confirm the validity of the research model presented in Chapter 3, which was built under the influence of the general observations presented in Chapters 2 and 3. However, this does not discredit the validity of the process, since the model nevertheless had to be exposed to the realities uncovered in detailed field observation. Therefore, this does not threaten the construct validity – although, possibly, the external validity. However, even the external validity seems not to have been significantly influenced by the process, since the observations influencing model design were based on a much broader scope of observations than those from the seven companies used in the study.

The next concern involves the wide focus of the research, spanning multiple academic areas. Although clearly defined through the research model and research questions, it requires rich cases, potentially obscuring causal relationships among the observed phenomena (“everything is important” [Yin 1981]). This is truly a concern worth addressing in future research, since it remains open whether the research design managed to eliminate it or not. Somewhat related is also the issue of generating alternative explanations to the observed phenomena and then selecting the most convincing. Although this is to some degree part of cross-case analysis as presented in Chapter 6, a more rigorous process could always be attempted.

The last concern related to construct validity emerges from the remark that case study researchers often point out good or bad outcomes of actions with little critical appraisal of the source of criteria from whence their notions of good or bad are drawn [Otley and Berry 1998]. As noted when discussing the problem of defining performance, this tended to be an even more general problem in the particular research setting, where it was difficult to define clear criteria. However, the solution may partly lie in the researcher declaring “ownership” of personal convictions, provided that these are clearly stated and made an explicit part of the research model context.

Most criticism of case study research refers to the internal validity test. A typical remark is that cases are nothing more than storytelling, with no rigorous analysis involved. Furthermore, participants (of case studies) often object to their findings [Miles 1979]. While a fairly systematic analysis according to the elements of the research model was attempted in the field study presented, some of the conclusions are based on simplistic logical thinking rather than

on more rigorous analytical tools. Internal validity was further enhanced by the research design elements presented in Table 4.1 and – a counter to the argument of Miles – the study's participants by and large did not object to its findings (most comments surrounded details of description not relevant to them).

Another argument is somewhat tautological: internal validity is damaged by biased witnesses (including the researcher, when he or she is part of the setting). Although witness bias can hardly be denied, use of witnesses cannot be avoided if the study is to be based on rich data, not publicly available. Thus, the researcher must make a deliberate decision on balancing the sources and has to use triangulation where possible. Although this study went significantly beyond the usual levels of triangulation, introducing seven different sources, one should be careful not to overestimate the effects. Some sources may seem independent, but may have used the same primary source of information without making it known (this problem was confirmed by the researchers in several cases).

Finally, one of the harshest arguments against case study research is lack of rigor in establishing controlled boundary conditions. The influence of variables beyond the researcher's control is unavoidable, and genuine internal validity becomes highly questionable. While this argument certainly has merit and the level of control was significantly below the strict criteria of the positivist approach to academic research, it is also highly debatable whether well-controlled experiments can be performed on complex social phenomena such as the subject of this research [Llewellyn 1992].

The arguments related to external validity are certainly more justified. Although the use of case comparison increased the level of relevance, generalization based on cross-case analysis certainly suffered from a low level of statistical significance. Cross-case pattern identification may have been subject to preconceptions held by the researchers, rather than being the result of convincing analysis of a large enough sample. A good understanding of the theoretical criteria for case selection has probably minimized this problem, but has most certainly not eliminated it.

Finally, the complaint about low reproducibility, although partly justified, has little true relevance and should probably be dismissed. A lengthy period of observation meant that conditions changed even during the course of research (which is perfectly acceptable for the model being studied), and the possibility of reliable repetition of the study was practically eliminated. However, this is the case with most social experiments.

Two principle suggestions can be made for future research. First of all, in order to increase the generalization potential of the research model, it would be highly desirable to conduct appropriate research on a sample of companies outside Central and Eastern Europe. Also, theoretical predictions from the literature do not necessarily restrict the model's validity to companies of the size examined in the presented study. Thus, additional research might test the model on multinational companies, or, conversely, on business units within large corporations.

In order to increase the internal validity, several new approaches to the research design might also be taken. An attempt might be made to use more quantifiable measurements and increase the size of the sample, thus combining a qualitative and quantitative methodology. Extensive use of closed questionnaires with answers on a scale might be one approach in this context; a

better definition of the outcome measurements (e.g. what constitutes successful change) would be another.

### **7.3 Contribution of the study to management theory**

Once the answers to the main research questions have been given, it is appropriate to consider the contribution of the study to management theory. As one might expect from the broad nature of the research topic, it contributes to several areas that are spanned by the concept of strategic change.

First of all, the study contributes to an understanding of strategic change as an integrative phenomenon. While the existing literature rarely approaches strategic change in this way, the study clearly demonstrates that no true understanding is possible without a linking of context, content and process. The study steps beyond a relatively general concept of context, content and process as building blocks of strategic change, towards the structuring of individual elements that translate these building blocks into more operational terms. Thus, the context-content-process model is translated into a trigger-design-implementation model. It is important to note that the new model not only explains the mechanisms by which context, content and process impact managerial reality, but also introduces time sequence, in the phases of strategic change. As opposed to previous integrative models, this one offers both simple and detailed explanations.

The next contribution of the study is that it places the perceived urgency and perceived feasibility of change in the foreground when considering the first stages of change. These two factors are directly related not only to the actual starting point of change, but also to the change goals. The study also explicitly links the two factors with a limited number of elements in the external and internal context which crucially influence the way management perceives these two key determinants of change.

Another contribution made by the study is the notion that change goals can be efficiently described using the new organizational template, with its defining of strategy, organizational structure and organizational systems. The study further defines the four principal outcomes of the design phase as (a) a decision not to change the organizational template in any major way, (b) a decision to change it without any obvious coherent pattern, (c) a decision to change it in a way corresponding to defensive restructuring, and (d) a decision to change it in a way corresponding to strategic restructuring. As noted above, the choice of outcome is influenced by the perceived urgency and perceived feasibility of change.

It is important to note that the study also responds to a theoretical dilemma in strategy design: should the company take an outside-in perspective (as would be the reasoning of, e. g., the environmental school), or an inside-out perspective (as does the resource-based view)? The answer is: both, since taking only one perspective does not provide all the answers needed for robust design of the new organizational template.

The study also contributes by defining clearly most of the important barriers to change which may be expected in defensive or strategic restructuring. It is particularly interesting to note that it finds the number of important barriers to be relatively small, contradicting usual notions on this subject.

Finally, the study makes a major contribution by linking the success of change implementation to the internal consistency of the organizational template, the availability of

certain critical resources, and the existence of certain leadership interventions. This contribution is particularly important since one of the biggest fallacies of the resource-based view, and the main reason for its lack of popularity with practicing managers, is its inability to clearly define the core resources for company success in a certain context, and how to build them. This study shows that, although critical resources and leadership interventions are not identical in defensive and strategic restructuring, both of the latter can be defined clearly, and both (a) place trust in a central position as the vital resource needed for change, and (b) view trust-building interventions as the primary task of change leaders.

#### 7.4 Implications of the study for practicing managers

Many philosophers and writers, including those in the areas of business and management, claim that change is the only constant in life (human and company). Change generates constant and numerous challenges for managers. What should be done to prepare the company for the next round of change? When is the right time to initiate change? What should be its scope and scale? What should change aim at? What kind of barriers can we expect? Once we initiate it, what should we do to make change happen?

If anything, this study witnesses the importance of change in the life of the companies observed. Although change was not always of the same intensity, no strategic goals were reached without a significant amount of it, and the companies had to undertake it once the goals were set. This is the first important message to managers: **do not hope to implement a chosen strategy without accepting that you will have to deal with change.**

Knowing, or – as many experienced managers may find more appropriate – sensing the right moment to commence strategic change may not necessarily be a skill found naturally in the realm of managerial “art”. While experience and “feeling” are welcome, managers should also accept the need for systematic observation of the context in which they operate. In particular, they should ask themselves: **does the organizational template (strategy, structure and systems) match the requirements of the context?** If not, they should expect that the company will, gradually at best or abruptly in a worst-case turbulent context scenario, lose any sustainable competitive advantage.

Contemporary management science offers many strategic tools for managers to use in strategic analysis, and many more are offered by consultants. Some are popular and widespread, and others are used by a limited few. Some claim to be simple, while others link their attractiveness to complexity. A good example is the influence of the positioning approach to strategy. Many managers in the companies observed used the powerful simplicity of “High Perceived Value versus Low Delivered Cost” paradigm to define their strategic goals. Without a doubt, this was helpful. They could explain their views to their colleagues and employees easily, and deploy the desired strategic position as a motivator. However, in taking this road they sooner or later ran into a major barrier: while it was easy to define and communicate the target strategic position, it was less easy to discover and convince others how that position translated into the company’s internal competences. Sometimes managers even found that the desired position was nothing more than a dream, since the competence gap was simply too wide. Therefore, managers would do well to **balance an inside-out perspective (based on internal competences) with an outside-in perspective (marked by strategic position)**. Regardless of how difficult it may be to achieve a clear and objective inside-out perspective, there is no hope of defining sufficiently clear change goals without it.

The above view has an important implication: **managers should prepare companies for change.** There are some generic measures that can be taken in this direction. First of all, managers should work towards creating mechanisms which support a regular strategic analysis process. They should involve both the external dimension and an understanding, explicit definition and communication of existing core competences, including culture. They should also build a “change infrastructure”, in particular a capacity for trust and communication with all key stakeholders. Finally, they should work towards strengthening middle management, which, as discussed below, is usually the key obstacle to change. Appropriate HR practices should be introduced, and middle managers stretched to develop knowledge, skills and attitudes.

Significant responsibility for timely commencement of change rests with corporate governance mechanisms, in particular (supervisory) boards. Strategic risk management should in any case be one of their key duties, and it is easy to see that tardiness in starting needed strategic change can greatly increase strategic risk. Governors should understand that **the commencement of strategic change is often related to change at the top of the company.** If the top manager refuses to recognize the need for a change which is obvious to others, gets involved in a string of non-aligned changes or opts for prolonged defensive restructuring, it is worth asking a simple question: can this person serve as change leader? Often it is not an alteration in external circumstances that triggers significant strategic change, but a fresh view from the top which uncovers previously unnoticed opportunities and provides a needed dose of focused energy.

A paradox related to initiating change makes managerial life difficult: while it is easier to start change in times of crisis, these are also the times when fewer resources are available and every mistake made more costly. Thus, **managers should not wait for the crisis to initiate strategic change.** They must find a way to create a feeling of perceived urgency of change, at least to the extent needed to move their immediate followers. This will allow them to make positive use of financial slack and other resources, otherwise typically believed to slow change down.

On the other hand, when managers recognize an urgent need for change which is not matched by appropriate resources, paralysis is not the answer. **Urgent need for change, even where it seems unfeasible, is a call for defensive restructuring.** If undertaken properly, defensive restructuring will lead to fast improvement of the financial position and serve as a good starting-point for strategic restructuring.

Remaining in the defensive restructuring phase for a long period of time (although there are no strict rules, most defensive restructuring processes should last less than a year), or returning from defensive restructuring to a situation of no change or non-aligned change, are dangerous. **Defensive restructuring is only half of the job, and should be followed immediately by strategic restructuring.** If it is not, the downward spiral is very likely to reappear and every subsequent round of defensive restructuring will prove more difficult.

Managers should understand that **defensive and strategic restructuring require significantly different organizational templates, critical resources and leadership interventions.** Thus, the transition from defensive to strategic restructuring is difficult and demands full managerial attention, as well as concentrated effort. Three issues deserve particular mention: organizational learning, decentralization and time. Organizational learning is absent during defensive restructuring, while it is a key enabler of strategic restructuring,



during which a global perspective, customer intimacy and new product development are typical requirements. Shifting the organization's focus from strict implementation and cost orientation to innovation and learning is not an easy task. It requires culture change, which cannot be achieved without the strong involvement of middle management. Decentralization is needed to support this involvement, as is time for the necessary competence building and the culture change itself.

Although most of the literature related to strategic change management emphasizes vision as the key component in strategic restructuring, one should not become the slave of a potentially empty phrase. **Managers should not wait for the “big vision” when initiating strategic change.** Vision can be effectively substituted by trust, which allows the leader to keep followers aboard even when steering through major changes in context. This also implies that strategic uncertainty should not be regarded as a block and an excuse not to engage in strategic restructuring. However, an absence of vision can potentially create entropy, since it serves as a framework and filter for strategic initiatives. Therefore, leaders should create a framework even if they do not declare it as a formal vision statement. One possible means of doing this is via a clear organizational template, and a focus on other elements of the 7S framework. The consistency of 7Ss is probably the best test of whether a vision exists in practice and how effectively it is translated into managerial action. Growth as a key objective should make up part of this framework.

External consultants and various improvement projects can be of help in turning the company around. However, managers need to be aware of the **tendency of consultants to engage in tactical projects, concerned with efficiency rather than value creation.** To quote Dr. Peter Kraljič from McKinsey & Co., this is not surprising as consultants are not entrepreneurial and strategic restructuring is closely associated with risk-taking. Also, the results of efficiency-focused projects are more predictable and show quicker results, both favorable points in typical consulting contracts.

Although strategic restructuring relies on trust and consistency, which in turn demand the intense participation of middle management, managers should be aware that **it is highly likely that a significant percentage of middle managers will not make it through strategic change.** Casualties will be fewer, however, if middle managers are intensively prepared for their new challenges, both in terms of education aimed at developing the right set of competences and organizational systems strengthening their new role in the organization. Nevertheless, middle managers are typically the biggest obstacle to change and often display a defensive attitude and much fear (of possible incompetence and of job loss). Thus they need help, and should be given clear change-goal-related tasks to be performed according to clear performance criteria, which they should fulfill in a fairly short space of time or face replacement. Transparency of rewarding and career decisions, as well as face-saving ways out where non-performance is evident, can significantly improve the trust level in an organization.

Top management bears the ultimate responsibility for the outcome of strategic change. This requirement is demanding, and the burden of it should be shared by all the members of the top management team. Although company cultures vary, **it is wise to use consensus as a decision-making mechanism for all issues related to strategic change, particularly in strategic restructuring.** If a small group at the top fails to reach consensus on a decision, then the chances of its successful and rapid implementation will be significantly smaller and it may prove better to delay it and seek a consensus-building alternative.

Finally, **strategic restructuring is a long process**. It may easily take a decade or more before a company reaches the level of sustainable competitiveness for which it was aiming. This means that managers should be prepared to endure long-term demands on their energy without loss of drive and consistency, and without making major mistakes in design and implementation. Only the support of all key stakeholders can facilitate change, rendering management of expectations critical and intense communication invaluable. Managers should also not forget that creating wins along the road will add to trust and patience. Therefore, **managing for today is just as important for strategic change as is managing for tomorrow**.

## **8. Nederlandse samenvatting**

### **8.1 Inleiding**

Het voornaamste doel van deze dissertatie is het ontwikkelen van een integraal analytisch kader gebaseerd op de nieuwste literatuur op het gebied van concurrentievermogen en strategisch veranderingsmanagement, aangepast aan de specifieke behoeften van Slovenië en Kroatië, om zo de waargenomen veranderingsprocessen te kunnen verklaren en ondernemingen te ondersteunen in hun toekomstige veranderingsprocessen.

Er zijn diverse redenen waarom het gekozen doel van wezenlijk belang is. Ten eerste zijn de verandering die hebben plaatsgevonden in Slovenië en Kroatië alleszins representatief voor de veranderingen in de bredere regio van Centraal- en Oost-Europa en daarnaast van een schaal, reikwijdte en snelheid die slechts zelden wordt waargenomen. Ondanks aanzienlijke algemene interesse van buiten de regio, werd er maar weinig onderzoek verricht op microniveau naar een verklaring voor de waargenomen verschijnselen en hun relatie met het strategische veranderingsmanagement. Gelet op het feit dat de veranderingsprocessen in de regio, inclusief bedrijfsherstructurering, nog in volle gang zijn, is een beter inzicht in hun aard niet alleen interessant vanwege de mogelijkheid tot generalisatie, maar tevens als hulpmiddel bij het voltooien van de gestarte herstructurering.

De volgende twee redenen waarom het onderzoek in deze dissertatie van breder belang is, zijn niet gerelateerd aan geografie, maar aan de aard van de geobserveerde ondernemingen en de gehanteerde benadering. Aan de ene kant kunnen alle waargenomen bedrijven als middelgroot qua omvang worden beschouwd. Ze hebben een paar honderd tot een paar duizend werknemers en zijn voornamelijk actief in regionale marktgebieden, maar zelfs de grootste verdienen niet het predikaat multinational. Vakliteratuur op het gebied van strategische veranderingen voor middelgrote ondernemingen is nogal schaars, aangezien het merendeel van het onderzoek hetzij verricht wordt in opdracht van grote multinationals of SME's. Tenslotte is veel van het onderzoek naar de fenomenen inzake strategische veranderingen ofwel gericht op de inhoudelijke kant, met name de concurrentiestrategie, ofwel het proces van veranderingsmanagement. Er zijn maar weinig pogingen gedaan om een integraal kader voor strategisch veranderingsmanagement te creëren, de meeste van hen eindigden als abstracte schema's met weinig praktisch nut voor de beroepskrachten in de managementsector.

Het eerste gedeelte van deze dissertatie presenteert een overzicht van de voornaamste gebeurtenissen in Slovenië en Kroatië in de waargenomen periode, om zo de lezer vertrouwd te maken met de context van strategische verandering. Vervolgens biedt de uitgebreide bespreking van vakliteratuur de mogelijkheid van het opzetten van een integraal onderzoeksmodel. Na de uitleg van de onderzoeksmethode worden gedetailleerde analyses van zeven ondernemingen besproken, die de periode 1991-2003 beslaan. Waarnemingen van afzonderlijke ondernemingen zijn geïnterpreteerd binnen het kader van het onderzoeksmodel en daarna heeft een kruisanalyse en de integratie van de onderzoeksbevindingen plaatsgevonden. Deze zijn op hun beurt gebruikt om het onderzoeksmodel verder te verfijnen en conceptuele gevolgtrekkingen af te leiden voor zowel de managementtheorie als praktiserende managers.

## **8.2 Kenmerken van veranderingsprocessen op macroniveau in Kroatië en Slovenië in de periode 1981-2002**

Kroatië en Slovenië vormen een interessante onderzoekskeuze vanwege hun overeenkomsten en verschillen. Beide maakten diverse eeuwen deel uit van het Oostenrijks-Hongaarse keizerrijk en bijna een eeuw als republieken van het voormalige Joegoslavië en haar voorganger het koninkrijk Joegoslavië. Tijdens het proclameren van hun onafhankelijkheid van het voormalige Joegoslavië verkeerden zij in vergelijkbare fasen van economische en politieke ontwikkeling. Een gedeelde geschiedenis gecombineerd met geografische nabijheid en de zelfde linguïstische en culturele wortels binnen de groep van Slavische naties impliceert belangrijke overeenkomsten in sociale en culturele context. Toch hebben beide landen zich als gevolg van diverse factoren vanaf 1991 zich opvallend anders ontwikkeld, waarbij hun onderlinge afwijking voor een groot deel een weerspiegeling vormt van het spectrum aan ontwikkelingspaden die in de rest van Centraal- en Oost-Europa zich voordeden. Daarom mogen zij worden beschouwd als een “klein universum” en vormen de situaties in hun afzonderlijke ondernemingen een potentieel uitgangspunt voor de generalisatie van strategische veranderingstheorieën.

Het voormalige Joegoslavië werd gekenmerkt door het politieke monopolie van de communistische partij. Het economische systeem was echter uniek en week aanzienlijk af van de planeconomieën van het Sovjettype. Het sleutelbegrip waardoor het economische systeem van het voormalige Joegoslavië zich onderscheidde van de rest van de wereld was het concept “sociaal eigendom”. Sociaal eigendom betekende dat de eigendomstitel van standaard handelsentiteiten niet berustte bij particulieren of de staat, maar geabstraheerd werd en aan de werknemers werd overhandigd. Theoretisch gezien betekende dit dat de werknemers zogoed als alle eigendomsrechten bezaten, zoals de bevoegdheid om een directeur te benoemen, goedkeuring te verlenen aan belangrijke strategische maatregelen – inclusief fusies, of het bepalen van de bestemming van winsten. Het beslissingssysteem van de werknemers werd “zelfmanagement” genoemd, waarbij het “werknemersbestuur” een rol speelde die vergelijkbaar is met die van een raad van bestuur. Dit leidde in de praktijk tot een hoog niveau van werknemersprivileges die in geen verhouding stonden tot de productiviteit en arbeidsethiek. Bij veel bedrijven werden de effecten nog verder versterkt door de afwezigheid van geschikt management, omdat de directeuren veelal vanuit de politiek benoemd werden en niet of nauwelijks een professionele opleiding hadden genoten en ook niet volledig verantwoordelijk waren voor hun prestaties.

Alhoewel de goederenmarkt geleidelijk aan geliberaliseerd werd en er een aantal componenten van de planeconomie werden geschrapt, waren de kapitaal- en arbeidsmarkten volledig onderontwikkeld. Vanwege politieke inmenging en het gemis aan feedback met betrekking tot de resultaten vanwege faillissementen, hetgeen normaliter zou hebben betekend het sluiten van slecht presterende bedrijven en het berispen c.q. ontslaan van slecht management, was de lokale economie nimmer in staat zich zelf te bedruipen.

Toen het moment aanbrak dat het voormalige Joegoslavië haar politieke betekenis verloor, stopte de toestroom van buitenlandse voorkeursleningen en stortte de economie ineen. De inflatie steeg en de politieke spanningen in Joegoslavië namen toe, hetgeen gedeeltelijk te wijten was aan de gigantische verschillen in regionale ontwikkeling, alsmede aan de ideologische verschillen tussen de diverse politieke elites in verscheidene delen van het land.

Toen Slovenië en Kroatië besloten om openbare verkiezingen uit te schrijven en onafhankelijk te worden viel Joegoslavië effectief uiteen. Militaire conflicten staken de kop op in Slovenië, doch deze werden snel opgelost, terwijl de er op volgende strijd in Kroatië, Bosnië en Herzegovina, Kosovo en Macedonië leidde tot een groot aantal slachtoffers en immense verwoesting.

Dit gebeurde tegelijkertijd met de ineenstorting van de Sovjetunie en turbulente veranderingen in de rest van Centraal- en Oost-Europa. Bijgevolg zagen bedrijven uit Slovenië en Kroatië hun thuis- en voornaamste exportmarkten inkrimpen of geheel verdwijnen, hetgeen enorme economische moeilijkheden tot gevolg had op het moment dat het economische systeem werd overgeschakeld naar een echte markteconomie. De bijkomende privatisering, enorme veranderingen in de sociale, politieke en juridische situatie, alsmede de sterkere regionale aanwezigheid van mondiale concurrenten zorgde voor additionele uitdagingen voor de lokale ondernemingen. De meeste van hen reageerden defensief door in te krimpen en de kosten aan te passen aan de afnemende inkomsten. Desondanks slaagden diegenen die de overgangsfase wisten te overleven er spoedig in nieuwe inkomstenstromen te genereren, vaak afkomstig van nieuwe markten en tevens te zoeken naar nieuwe methoden om hun concurrentievermogen te verbeteren.

### 8.3 Literatuurbespreking

Gelet op de intentie om strategische verandering te benaderen als een integraal verschijnsel diende de te bespreken literatuur zowel de inhoud als het proces van strategische verandering te bestrijken. Daarnaast moest ook de belangrijkheid van de theoretische concepten binnen de waargenomen context worden beoordeeld.

Wat betreft de inhoud van verandering richten de kwesties zich op concurrentievermogen. Concurrentievermogen ontpopt zich tot centraal begrip zowel in de eerste periode van verandering, waarin ondernemingen zich inspannen om zich snel aan te passen aan de nieuwe omgeving en erin slagen een efficiencycurve te bereiken die hun in staat stelt concurrerend te zijn in de opnieuw gedefinieerde markten, alsmede in de tweede fase, waarin ondernemingen hebben gepoogd zich aan te passen aan de alsmaar toenemende concurrentiedruk. Bijgevolg vertegenwoordigt concurrentievermogen in een sterk dynamische omgeving een dimensie in het onderzoeksmodel en was een literatuurbespreking noodzakelijk als hulpmiddel bij het bouwen van een model binnen deze context.

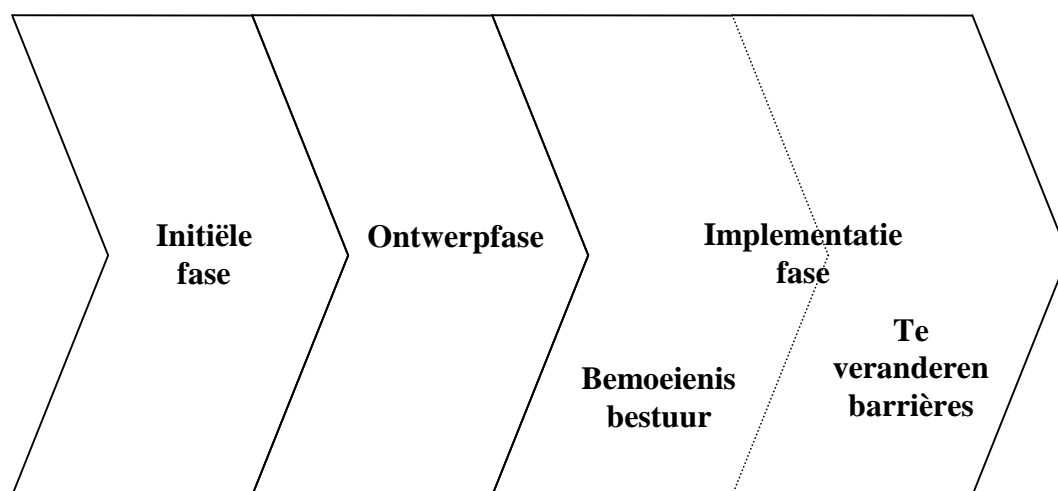
Desalniettemin ziet het er naar uit dat het proces van verandering, met name bemoeienis van het bestuur, een evenzo belangrijk deel van de puzzel vormt. Gelet op het hoge niveau van algemene onzekerheid, enorme dagelijkse druk en de aanzienlijke algehele stress in de samenleving en onder de werknemers, hadden de managers een zware kluit aan het opzetten en aansturen van het veranderingsproces. Daarom vormt het veranderingsproces de tweede dimensie van het onderzoeksmodel, idem dito gebaseerd op de juiste bespreking van de vakliteratuur.

Opvallend was de sterke invloed van diverse economische theorieën t.a.v. industriële organisatieleer als uitgangspunt voor overwegingen van te handhaven concurrentievoordeel (als definitie van de inhoud van de verandering), terwijl wetenschappen zoals psychologie en sociologie de meeste invloed lijken te hebben gehad op overwegingen van strategisch veranderingsmanagement als een veranderingsproces.

Het nalezen van vakliteratuur die zich bezighoudt met te handhaven concurrentievoordeel wijst erop dat er twee mogelijke benaderingen bestaan, elk met bepaalde voor- en nadelen. De eerste, waarvan de omgevingstroming de meest gevestigde exponent vormt, hanteert de van buiten naar binnen-optiek, zoekend naar bronnen van concurrentievoordeel door middel van interpretatie van de externe omgeving. De tweede, waarvan de bronstroming de meest dominante vertegenwoordiger is, kiest een van binnen naar buiten-optiek, waar concurrentievoordeel wordt gekoppeld aan interne factoren. Tegelijkertijd zorgt het nalezen van literatuur over strategische verandering voor een focus op kwesties die gerelateerd zijn aan de aard van veranderingen en integraal veranderingsmanagement. Het geeft duidelijk in overweging dat verandering dient te worden beschouwd als een proces dat zich in fasen ontwikkelt.

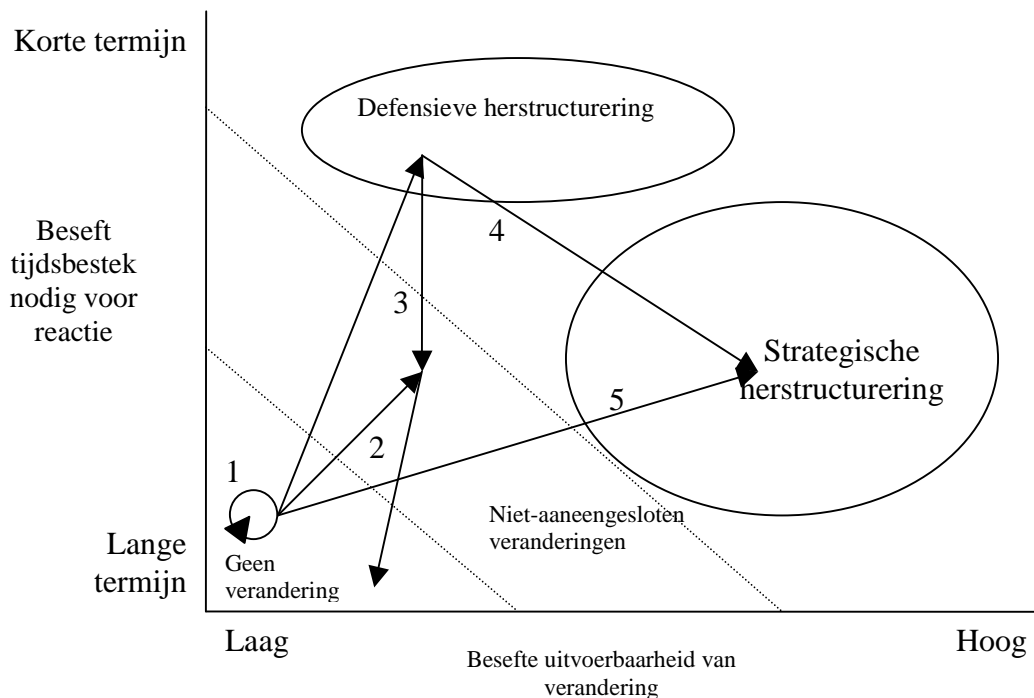
De geraadpleegde vakliteratuur besloeg een vrij uitgebreid spectrum aan theorieën en daarop gebaseerde concepten. Van twintig verschillende concepten werd vastgesteld dat zij bijzonder interessant zijn in de waargenomen context. Op diverse manieren leveren zij allemaal het fundament waarop het onderzoeksmodel is gebouwd. Het is bijna een paradox, dat het doel, het construeren van een simpel onderzoeksmodel van strategisch veranderingsmanagement dat inzicht verschaft in de waargenomen strategische transformaties van bedrijven in Kroatië en Slovenië werd bereikt, ondanks het feit dat het werd afgeleid uit een veelheid van – vaak complexe – concepten en ver reikende daar onderliggende theorieën.

Het onderzoeksmodel beschreef strategische verandering als een gegeven dat in drie fasen optreedt: initieel, ontwerp en implementatie met daarin te veranderen barrières en bemoeienis van het bestuur (Fig. 8.1). Het definieert tevens de sleutelbegrippen van de afzonderlijke fasen. In de initiële en de designfase bestaan deze uit de besepte urgentie en de uitvoerbaarheid van verandering, die niet alleen de het besluit om tot verandering over te gaan beïnvloeden, maar ook de beoogde uitkomst: het geplande organisatiestructuur (strategieën, systemen en structuren).



Figuur 8.1 Strategisch veranderingsmanagementmodel

Het onderzoeksmodel legt aan de ene kant de link tussen de besepte urgentie en de uitvoerbaarheid van verandering en aan de andere kant de keuze van de herstructureringsbenadering, waarbij defensieve en strategische herstructurering als alternatieve methoden worden aangeduid. (Fig. 8.2).



Figuur 8.2 Uitkomsten van de ontwerpfase

Tenslotte leverde het naslaan van de vakliteratuur een verzameling attributen van het defensieve en strategische herstructureringsproces op, waardoor waarnemingen uit de implementatiefase konden worden geconceptualiseerd, met name de kenmerken van nieuwe organisatiesjablonen, de essentiële bronnen voor hun succesvolle implementatie, te veranderen barrières en bestuurlijke interventies.

Naast de constructie van het onderzoeksmodel werden er gedetailleerde vragen opgesteld die door veldonderzoek moesten worden beantwoord:

V1. Welke factoren hebben de besepte noodzaak tot verandering beïnvloed? Welke factoren hebben in het bijzonder het besepte benodigde tijdsbestek voor verandering beïnvloed?

V2. Welke factoren hebben de besepte uitvoerbaarheid van verandering beïnvloed?

V3. Wat was, voor zover aanwezig, het responspatroon t.a.v. het besepte benodigde tijdsbestek voor actie en het besef van de uitvoerbaarheid? Hoe was de reactievolgorde?

V4. Indien defensieve herstructurering tot de reacties behoorde, hoe geschiedde dat? Wat waren de sleutelbegrippen in het nieuwe organisatiestructuur? Welke essentiële bronnen waren er nodig? Wat waren de voornaamste bestuurlijke ingrepen tijdens de implementatie en de moeilijkheden tijdens het implementeren van het nieuwe sjabloon?

V5. Indien strategische herstructurering tot de reacties behoorde, hoe geschiedde dat? Welke essentiële bronnen waren er nodig? Wat waren de voornaamste bestuurlijke ingrepen tijdens de implementatie en de moeilijkheden tijdens het implementeren van het nieuwe sjabloon?

#### 8.4 Onderzoeksmethodiek

De casusmethode werd gekozen als zijnde de meest geschikte benadering voor deze specifieke situatie. Hierbij werd een kwalitatieve, ten faveure van een kwantitatieve benadering gehanteerd, zowel vanwege de aard van de vragen, die grondige observatie en interpretatie vereisten, alsmede de relatief kleine onderzoeksomvang van beschikbare bedrijven. Daarnaast worden casussen algemeen geaccepteerd als een adequaat hulpmiddel bij het onderzoek naar zowel onderwerpen met betrekking tot de brongerichte gedachtegang als startparadigma voor de analyse van de inhoud van een strategie, alsmede onderwerpen omgeven door organisatiegedrag en veranderingsmanagementprocessen, die in de buurt komen van traditionele onderzoeksmethoden in de sociale wetenschappen.

De bij het veldonderzoek betrokken ondernemingen werden voorbereid om toegang te verschaffen tot alle noodzakelijke informatie en beschikten over het potentieel om representatief te zijn en voldoende informatierijke voorbeelden. De data en observaties werden verzameld uit zeven brongroepen, inclusief de systematische beoordeling van krantenknipsels, jaarverslagen, voor de betreffende bedrijven voorbereide consultancyprojecten, studievoorbeelden m.b.t. de bedrijven, gestructureerde interviews met zorgvuldig geselecteerde managers (de belangrijkste bron, er werden 62 interviews afgenomen met zowel het merendeel van de raad van bestuur als vertegenwoordigers van het middenmanagement) en feedback van het management op de voorlopige bevindingen van het onderzoek. De data en observaties richtten zich op de periode 1991-2003. Na het verzamelen ervan, werd een controle op consistentie uitgevoerd, vervolgstellingen die niet minstens door twee methodieken werden gestaafd (niet slechts extra bronnen binnen dezelfde methode) werden verworpen.

De observaties uit het veldonderzoek werden apart van elkaar geanalyseerd en kruiselings met de overige casussen vergeleken. De bevindingen werden verder gepreciseerd met de hulp van een onafhankelijke expert, die de rol van advocaat van de duivel speelde en vraagtekens plaatste bij de voorlopige conclusies. De verbeterde casusschets werd naar de betrokken ondernemingen gestuurd, waarbij het topmanagement om feedback werd gevraagd. Alle zeven firma's bevestigden dat de casussen een juiste weergave en interpretatie vormden van de observatieperiode.

Een specifiek methodologisch probleem vormde de berekening van de geassocieerde paarwaarden bij besepte noodzakelijkheid en besepte uitvoerbaarheid, die, in overeenstemming met het onderzoeksmodel, de uitkomst definieerden. Naar aanleiding van de interviews met de managers en de analyse van het besluitvormingsproces werden er gewichtswaarden toegekend aan de individuele factoren die de besepte noodzakelijkheid en besepte uitvoerbaarheid hebben beïnvloed. Deze werden opgeteld of afgetrokken, afhankelijk van hun aanwezigheid in een individuele veranderingsfase of de aard van hun invloed op de beslissing. De eindresultaten werden afgebeeld in diagrammen om zo een voorspelling te kunnen geven van het karakter van de beoogde uitkomst. (zie Fig. 8.2).



Het veldonderzoek bracht twee belangrijke methodologische beperkingen naar voren: generalisatiepotentieel (speciaal in het geval van specifieke context en een kleine onderzoeksomvang van bedrijven), alsmede een voor verbetering vatbare betrouwbaarheid van de kwalitatieve analyse m.b.t. de berekening van de geassocieerde paarwaarden bij het besepte noodzaak-besepte uitvoerheidsdiagram. De eerste tekortkoming vraagt om soortgelijk onderzoek buiten Slovenië en Kroatië, terwijl de tweede overwonnen zou kunnen worden met het gebruik van meer kwantificeerbare metingen en een vergroting van de onderzoeksomvang.

### **8.5 Strategisch veranderingsmanagement: de casussen van zeven Kroatische en Sloveense bedrijven.**

Zeven productiebedrijven werden geselecteerd voor het veldonderzoek: Končar, Lura and Podravka uit Kroatië, and Gorenje, Kolinska, Lek and Ljubljanske mlekarne uit Slovenië. Elke casus (behalve Lura, dat werd opgericht in 1991) begint met een korte samenvatting van de bedrijfsgeschiedenis van voor 1991. Hierna volgt een overzicht van de bedrijfsontwikkelingen in de periode 1991-2003, gecategoriseerd onder kopregels die in chronologische volgorde de waargenomen veranderingscycli weergeven. Elke casus besluit met een bespreking van de onderzoeksbevindingen, samengebracht rondom de elementen van het onderzoeksmodel.

#### **8.5.1 Gorenje**

Bij Gorenje werden er vier veranderingscycli waargenomen. In de eerste cyclus begon de verandering laat, toen de financiële situatie (en met name de liquiditeit) van het bedrijf kritisch werd. De belangrijkste factoren die van invloed waren op deze late start waren institutionele druk (om de werkgelegenheid te handhaven en om het positieve imago van het bedrijf en haar topkader in stand houden); gebrek aan transparantie in de gevolgen van externe veranderingen m.b.t. de bedrijfsprestaties en gebrek aan eenheid onder de top van het management. De rol van het financiële overschot kan als negatief worden beschouwd, omdat de verandering pas werd doorgezet nadat deze was opgebruikt.

Zodra de verandering in gang was gezet vertoonde deze de overduidelijke kenmerken van defensieve herstructurering. De gekozen strategie werd sterk beïnvloed door institutionele druk. Er vond inkrimping plaats in de hoofddivisie, hoewel uitsluitend door vrijwillig vertrek, inclusief pensioneringen. Het nieuwe organisatiestructuur bevatte een aanzienlijke hoeveelheid centralisatie in de eerste veranderingsperiode en een focus op kostenbesparing en bestaande centrale markten. Er was geen spoor van ingrijpende bedrijfsleerprocessen, alhoewel er een duidelijke nadruk was op kwaliteitsverbetering gebaseerd op strengere discipline. De essentiële bronnen voor het slagen van de strategie in deze fase waren financiële injecties, een nieuw boekhoud- en controlesysteem, marktvaardigheid en een toegewijd leger aan arbeidskrachten dat haar leiders vertrouwde. Bestuurlijke interventies beperkten zich tot topdown besluitvorming en intensieve communicatie met de werknemers en andere belangrijke belanghebbenden. Een bepaalde hoeveelheid dwang was merkbaar, maar dit werd gecompenseerd met beloften van behoud van werkgelegenheid. De grootste barrière was angst, in het bijzonder bij het middenmanagement.

De tweede fase ging door met de nadruk op kostenbesparing, maar op een geheel andere wijze: het werd gebruikt als een onderdeel van de concurrentiestrategie in plaats van een crisisreactie en werd gecombineerd met andere activiteiten om de toegevoegde waarde te verbeteren. Op deze wijze veranderde de herstructurering van een defensieve in een strategische. De essentiële bronnen voor het begin van de strategische herstructurering waren financiële middelen en technologische vakbekwaamheid. Een andere duidelijke afwijking van de eerste fase was het meer vertrouwen op bottom-up processen en duidelijke pogingen om nieuwe bedrijfsprocessen te lanceren die het leerproces zouden vergemakkelijken, zoals het inzetten van buitenlandse consultants en het richten van de aandacht op technische scholing.

De aanzet voor de derde veranderingscyclus was de interpretatie van het bestuur van de nieuwe mogelijkheden in Centraal- en Oost-Europa en de concurrerende bewegingen in de branche, alsmede hun herinterpretatie van de behoeften en verlangens van de consument in alle markten. De aanzet werd versterkt door de schatting dat de beschikbare bronnen toereikend waren om de veranderingen in praktijk te brengen. Het bedrijf besloot om het lage kosten- en hoge toegevoegde waarden-standpunten te combineren; het reorganiseerde de hoofdproductielijnen en legde de nadruk op R&D, productie en distributie en wijzigde haar koers in de richting van globale criteria en externe partnerschappen om zo de kritieke onderdelen in haar waardeketen te verbeteren. Gorenje bleef vertrouwen op alle essentiële bronnen die tijdens de defensieve herstructurering waren vastgesteld, met een intensivering van het gebruik van technologische vakbekwaamheid en klantenbinding om nieuwe producten te ontwikkelen.

In de derde cyclus liep de onderneming tegen barrières aan die te maken hadden met de groeiende meervoudigheid aan interesses, maar kon deze neutraliseren, voornamelijk dankzij een hoger niveau van decentralisatie, meer ad-hoc management en voortdurende intensieve communicatie, alsmede druk uit te oefenen op de prestaties van het middenmanagement.

Terwijl de organisatiestructuur dat resulteert uit de vierde cyclus nog niet volledig uit de verf is, is het duidelijk dat de aanzet voor deze cyclus bestond uit de interpretatie dat de contextuele veranderingen (met name de toetreding tot de EU gecombineerd met ontwikkelingen in de branche) significant genoeg waren om direct tot actie over te gaan. Het is ook zeer waarschijnlijk dat deze beslissing zwaar beïnvloed werd door een voorspelde toename in institutionele druk.

#### 8.5.2 Kolinska

Twee veranderingscycli zijn waar te nemen bij Kolinska in de periode 1991-2003. Er zijn een aantal aanwijzingen dat de onderneming zich in de overgang naar een derde fase bevindt. De eerste cyclus werd duidelijk gekenmerkt door een stoutmoedige inkrimping en vertoonde alle tekenen van een defensieve herstructurering. De verandering werd ingezet door een inschatting van het management dat de marktontwikkelingen gelijk overeenstemden met een van hun voorgedefinieerde scenario's.

Een vroege start, snel inkrimpen en andere kostenbesparende maatregelen stelden het bedrijf in staat om een ernstige financiële crisis te vermijden ondanks de gigantische uitdagingen van een aanvankelijke inkomstendaling van 70 %. Het gegeven dat de onderneming een betrouwbare managementadministratie had geïnstalleerd, vergrootte de snelheid en nauwkeurigheid van haar reactie. Het beperkte tevens de potentiële schade van financiële overschotten, aangezien het bedrijf de "overschotverbrandratio" gemakkelijk kon controleren en in actie kon komen toen de financiële reserves nog groot waren.

De onderneming probeerde ook de inkomsten te vergroten, maar behaalde slechts “meer van hetzelfde”. Alle belangrijke beslissingen werden volledig gecentraliseerd op het niveau van de Raad van Toezicht. Verbeteringen in specifieke productie- en distributieprocessen werden voornamelijk uitgevoerd op basis van bedrijfsinzichten, zonder het profijt van externe ondersteuning of vergelijkend onderzoek mondiale concurrenten. De essentiële bronnen die in de in de eerste cyclus werden gebruikt waren onder andere voorzichtig gebruik van financiële overschotten en diverse institutionele verbanden, intensieve benutting van het kostenbeheersysteem en vertrouwensmanagement voor de werknemers.

Bestuurlijke interventies richtten zich op gecentraliseerde besluitvorming en strikt brongebruik – deze werden aangewend voor kostenbesparing en distributieondersteuning. Het management was betrokken bij een belangrijk communicatie-initiatief, maar maakte ook gebruik van dwang om het herstructureringsproces te versnellen. Het gebrek aan vaardigheden en kennis vormde een belangrijke hindernis bij de verandering, net zo als angst voor baanbehoud. Deze factoren werden ook beschouwd als doorslaggevende beperking bij het vermogen van het bedrijf om actief deel te nemen aan organisatorische leerprocessen.

Zodra de directe dreiging van financiële ineenstorting was opgeheven, schatte het management opnieuw de noodzaak en de uitvoerbaarheid van verandering in. Verscheidene opties m.b.t. strategische herstructurering werden afgewezen, vanwege de aanname dat het bedrijf niet over voldoende bronnen beschikte om ze te implementeren, alhoewel de directie in het algemeen de noodzaak tot verandering onderschreef. Tenslotte droegen een afnemende gelijksoortigheid in de top en een afnemend vertrouwen ook bij aan de veranderingsmodus, welke vasthield aan een aantal elementen van defensief herstructureren gecombineerd met een aantal niet-aaneengesloten wijzigingen.

Deze situatie leidde tot een verslechtering van de strategische positie. Kolinska kan nog steeds bogen op gezonde financiële resultaten, maar het presteert onder het branchegemiddelde en schijnt niet in staat te zijn om significante vooruitgang te boeken in het verwerven van de vaardigheden die nodig zijn voor een strategische herpositionering. De interne communicatie is verre van optimaal en het vertrouwen in de leiding van de onderneming neemt af.

### 8.5.3 Končar

Er zijn drie veranderingsfasen waar te nemen in de Končar-casus, waarbij de grens tussen de eerste twee enigszins vaag is. De aanzet tot de eerste fase was de verslechterende financiële situatie van het bedrijf. Deze werd laat opgemerkt, omdat de rapportagesystemen van Končar niet toereikend waren en het moeilijk was om een actueel overzicht te krijgen van de algehele bedrijfsprestaties.

De inschatting van de situatie door de directie werd zwaar beïnvloed door de aard van de branche, alsmede de politieke en economische veranderingen in de omgeving. Tenslotte was de onderneming net in een machtsvacuüm beland, vanwege het plotselinge overlijden van haar vorige bestuurder. Al deze factoren werden beschouwd als uitermate negatief voor de kans op verandering, hetgeen het management blokkeerde en externe krachten dwong om het heft in handen te nemen.

Een defensieve herstructurering werd opgestart, waarbij de voorkeur werd gegeven aan een faillissement op divisieniveau als korte termijnmiddel. De aandacht richtte zich hoofdzakelijk op kosten en financiële liquiditeit. Het zich ontdoen van bedrijfsmiddelen bood weinig

soelaas, vanwege de slechte economische omstandigheden in het land. Vanwege de late reactie en het totaal onprofessionele interim-management waren de financiële reserves al uitgeput voordat de verandering überhaupt werd ingezet. De interne controlesystemen waren niet adequaat. De hoge zelfstandigheidsniveaus van de afzonderlijke divisies verkleinden de transparantie van de bedrijfsprestaties voor het bestuur. De schok van de eerste inkrimpingsfase elimineerde zo goed als alle vertrouwen in de directie en in aanzienlijke mate dat in het middenkader. Er werd gepoogd bottom-up veranderingen door te voeren, maar het bestuur was niet actief betrokken bij de communicatie en het opbouwen van vertrouwen en konden uitsluitend dwang gebruiken om het divisie-management aan te sturen. De moeilijkheden waarmee het bestuur geconfronteerd werd – afgezien van een extreem vijandige zakelijke omgeving – waren gebrek aan vertrouwen, angst en verwarring en flagrante non-technische competentie. Er werd praktisch niet geïnvesteerd in opleidingen.

Ondertussen had het divisie- en middenkader onder de nieuwe omstandigheden enige zakelijke ervaring opgedaan en hadden de divisies hun vakbekwaamheden aangescherpt. De inkrimping werd verder doorgezet en de meeste kenmerken van defensieve herstructurering bleven, alhoewel deze herstructurering geschiedde zonder een duidelijk doel voor ogen. In deze context kan worden betoogd dat er een tweede veranderingsfase was aangebroken met gedeelde kenmerken van defensieve herstructurering en van niet-aaneengesloten veranderingen, waarbij de eerste vertegenwoordigd was in de filosofie van de bedrijfstop en de tweede in de initiatieven van het divisiekader. Nog een te slecht hindernis stak in de context van privatisering en slechte controlesystemen de kop op: een toenemende discrepantie van interesses onder divisie-managers en andere interessegroepen.

De aanzet voor de derde fase was direct gerelateerd aan de veranderingen in de top. De nieuwe voorzitter van de raad van bestuur schatte de uitvoerbaarheid van het strategisch verbeteren van het concurrentievermogen positief in door het vergroten van de synergie tussen de divisies. Alhoewel het moederbedrijf nog steeds een bronnentekort had, begon het met de divisies aan te sporen om zich te richten op de doorslaggevende succesfactoren, van technologische vakbekwaamheid en nieuwe producten tot het bouwen van vertrouwensrelaties met klanten en managementontwikkeling. Končar begon ook met een actieve participatie in organisatorische leerprocessen omtrent de meest effectieve mondiale praktijken, door middel van consultancyprojecten, systematische betrokkenheid bij biedprocessen en internationale trainingsprogramma's.

Hiermee werd een aanzienlijke verbetering in de prestatietransparantie van zowel afzonderlijke divisies als het systeem in zijn geheel bereikt. De nieuwe bestuursvoorzitter gebruikte zijn charisma ter compensatie van zijn enigszins autoritaire stijl, maar zorgde tegelijkertijd dat de andere leden van de raad van bestuur erbij betrokken werden en liet veel ruimte voor divisie-initiatieven. Op deze manier vermeid hij totale centralisatie en verder verzet van de divisies.

#### 8.5.4 Lek

In de recente geschiedenis van Lek zijn vier veranderingscycli aan te wijzen. De aanzet voor de eerste fase was de interpretatie van het bestuur van Lek m.b.t. haar zakelijke overlevingskansen ondanks haar relatief solide financiële aanvangspositie. De schatting werd beïnvloed door de aard van de branche alsmede het gebrek aan transparantie t.o.v. kern versus niet-kernactiviteiten. Het vertrouwen in het bestuur had een positieve invloed op het begin van de verandering, terwijl financiële overschotten de eerste reactie vertraagden, maar deze uiteindelijk de verandering ondersteunden toen deze begon.

De organisatiestructuur werd qua strategische focus aangepast, in die zin dat de aandacht zich meer richtte op de kernactiviteiten en de centrale en Oost-Europese markten, de organisatieopzet (een divisiestructuur om de prestatietransparantie te vergemakkelijken, maar met een hoog centralisatiegehalte) en de tactische gevolgen (kostenbesparing door technische aanpassingen en inkrimping).

Na het bereiken van de resultaten van de defensieve herstructurering werd de tweede veranderingscyclus gestart, waarin de onderneming de ommekeer maakte naar strategische herstructurering. Alhoewel er geen duidelijke en krachtige toekomstvisie werd uitgesproken, was deze helder genoeg om als kader voor de strategie te kunnen dienen. Het liet tevens ruimte voor het veranderen van de interpretatie van prioriteiten.

In de derde cyclus ging de onderneming van een strategische herstructureringsmodus over naar een niet-aaneengesloten veranderingsmodus. De top van het bestuur werd gewijzigd, waardoor verandering in de organisatiestructuur optraden, ondanks de aanname dat er geen grote veranderingen in de strategie noodzakelijk waren. Vanwege de inschattingsverschillen onder de topmanagers m.b.t. de betekenis van externe gebeurtenissen en in hoeverre de onderneming daartegen opgewassen was, was er in Lek geen eensgezindheid ten aanzien van de noodzaak en richting van verandering. Pas nadat het middenkader en een aantal van de meer ervaren managers de noodzaak tot verandering als urgent hadden bestempeld, werd de aanzet gegeven tot de volgende veranderingsfase, ondanks haar ogenschijnlijk magere succesansen (gebrek aan steun van de raad van toezicht en de weerstand in de publieke media). Het vertrouwen onder de voornaamste belanghebbenden speelde een doorslaggevende rol bij de mate van succes van initiatieven in deze periode.

In de vierde veranderingscyclus wijzigde het bedrijf opnieuw haar koers richting strategische herstructurering, met het doel om een mondiale speler te worden. Tezamen met een duidelijke positionering als een globale generieke onderneming met het vermogen tot toegevoegde waarde werd er expliciet binnen de onderneming verwezen naar onderdelen van de waardeketen die de positie ondersteunden vanuit een kosten- en toegevoegde waardeperspectief. Er werd veel geleerd van de vergelijkende onderzoeken die door ingehuurd consultants werden uitgevoerd en de integratie met Novartis, welke het resultaat was van de inschatting van de directie dat Lek zich het beste kan ontwikkelen onder de vleugels van een strategische partner.

Wat bestuurlijke interventies betreft hield het bedrijf vast aan het topdown besturingsmodel. Echter, het projectmanagement zoals dat door Lek wordt gebruikt, kan worden geïnterpreteerd als een participatieconstructie, als compensatie voor het relatief regelmatige ontslag van beneden de maat presterende managers uit het middenkader.

Tenslotte waren de hindernissen gedurende de strategische herstructureringsfasen voornamelijk gerelateerd aan angst onder werknemers, en in het bijzonder onder het middenkader, dat ze niet voldoende competent zouden zijn voor hun nieuwe taakomschrijving. Veranderingsmoeheid was merkbaar, maar deze werd als hindernis grotendeels geëlimineerd door het hoge impliciete beloningspotentieel van de fusie met Sandoz, alsmede door de relatief hoge frequentie van veranderingen van posities in het middenkader.

### 8.5.5 Ljubljanske mlekarne

Er zijn drie fasen waar te nemen in de casus van Ljubljanske mlekarne, en er zijn aanwijzingen dat de vierde fase op het punt van aanbreken staat. In de eerste fase wijzigde de onderneming haar organisatiestructuur ten opzichte van de voorgaande periode, maar slechts in bescheiden mate. Volgens de directie vroegen de veranderingen in de omgeving niet om een directe reactie die verder ging dan aandacht voor de kosten en een informele personeelsstop. De directie werd beïnvloed door gemengde signalen m.b.t. de veranderingen in de branche en de financiële situatie van het bedrijf, te wijten aan problemen met het middenkader en de aspiraties van de directeur om de koppositie in Slovenië te bereiken. Als gevolg daarvan werden een aantal verbeteringen doorgevoerd, maar het bedrijf week niet af van haar productierichting en het tamelijk lokaal georiënteerde businessmodel. De hoeveelheid organisatorische leerprocessen in deze periode lijkt uitermate beperkt, hetgeen grotendeels het resultaat was van de intimiderende manier van leiding geven van de directeur.

De tweede fase werd aangezweld door privatisering, de aannamen van de directie t.a.v. de toekomst van de Sloveense zuivelindustrie en het continue streven van de directeur om marktleider te worden. Hij ging er van uit dat het bedrijf beperkte maar voldoende bronnen bezat, alhoewel hij zich voornamelijk richtte op de financiële en de productiekant, in tegenstelling tot personeelomvang en aan de markt gerelateerde vakbekwaamheid. Ondanks de aanwezigheid van een potentieel voor strategische herstructurering, ging de mogelijkheid daartoe al verloren in de opzetfase. Er werd geen blijk gegeven van een duidelijke visie, noch van een optimalisering van de synergie van de bronnen of andere pogingen om de organisatiestructuur te wijzigen. Bijgevolg was er een onmiddellijke verschuiving naar niet-aaneengesloten verandering, in plaats van strategische herstructurering.

De derde fase werd ingeluid door de nieuwe beoordeling van de nieuwe directeur en zijn team. Zij hadden de situatie veel kritischer bekeken en kwamen tot de conclusie dat onmiddellijke actie noodzakelijk was, ondanks tegenwerkende krachten in en om het bedrijf die de kansen op succes verkleinden. Als eerste beschouwden zij de veranderingen in de branche als uitermate negatief, en zagen daarbij veel meer dreigingen dan kansen in de toetreding tot de EU. Zij schatten ook dat voortdurende institutionele druk een negatieve rol zou kunnen spelen bij de onderneming. Alhoewel ze niet in voldoende mate over transparante prestatiecijfers beschikten, schatten zij dat de financiële stabiliteit van het bedrijf niet langer dan een paar jaar stand zou houden.

De nieuwe directeur maakte zich ook zorgen over de erfenis van de verstoorde bedrijfscultuur en het zeer beperkte aantal van capabele managers. Dit vroeg om defensieve herstructurering met centrale besluitvorming, een duidelijke focus op kostenbesparing en in het bijzonder de consolidering van productiefaciliteiten. Helaas zorgden sterke institutionele druk en een relatief solide financiële positie op de korte termijn ervoor dat de directie niet kon overgaan tot drastische maatregelen.

Naar aanleiding van het succes van de derde fase en een verbeterd inzicht in de eigen vaardigheden, koos het bestuur bij de aanvang van de vierde cyclus voor een nieuwe strategische positie, die meer werd bepaald door het toevoegen van waarde middels een uitstekend productenportfolio, een beter op haar taken berekende regionale distributie en een verbeterde merkpositie. De eerste stappen, zoals de initiatieven tot het ontwikkelen van nieuwe producten of het project om de merknaam te verstevigen, werden volgens de nieuwe koers gezet. Desalniettemin werd er door middel van strategische projecten meer bottom-up

steun voor verandering gegenereerd, hetgeen uiteindelijk onvermijdelijk leidde tot een nieuwe selectieronde in het middenkader. Er werd uitgegaan van een globaal perspectief, vergezeld van een significante hoeveelheid van vergelijkend onderzoek en leren van andere bedrijven buiten de directe regio.

#### 8.5.6 Lura

Er zijn vier afzonderlijke perioden aan te wijzen in de geschiedenis van Lura. In de eerste veranderde het bedrijf niets aan haar strategie of de basiselementen in haar organisatiestructuur. Er werd geen daadwerkelijke herstructurering doorgevoerd in de aangekochte ondernemingen. De productierichting van de overgeërfde bedrijven van de voorgaande periode had de overhand, alhoewel er een aantal verbeteringen in de productie en distributie werden doorgevoerd. De voornaamste oorzaken liggen in het privatiseringsproces, waarin de eigenaar vrije cashflow gebruikte om andere ondernemingen over te nemen, in plaats van degene die hij al reeds had aangeschaft te herstructureren, alsmede de oorlog in Kroatië, die de concurrentie aanzienlijk decimeerde en Lura in staat stelde om goede bedrijfsresultaten te behalen zonder significante verbeteringen door te voeren. Ten slotte besloot de eigenaar om de onderneming zelf te leiden, maar ontbeerde daarbij de benodigde managementervaring, waardoor hij aarzelde bij het nemen van belangrijke strategische ingrepen.

De aanzet tot de tweede cyclus vormde de aanname dat de financiële situatie van het bedrijf zou verslechteren vanwege de veranderingen in de sector, hoofdzakelijk samengaan met de toetreding van globale concurrenten en consolidatie van de detailhandel. Institutionele druk kon deze verandering niet tegenhouden, maar beïnvloedde de snelheid en wijze van uitvoering. De aanwezigheid van voldoende financiële bronnen had een positieve invloed nadat er besloten werd, dat actie noodzakelijk was. De eigenaar kon daarbij rekenen op zijn positie als een leider die vertrouwen genoot, welke hij in de eerste fase had opgebouwd.

De aard van de veranderingen was duidelijk defensief, gelet op de focus van de onderneming op kostenbesparing en in het bijzonder inkrimping. Ondanks veranderingen in de top, was de besluitvorming nog steeds in hoge mate gecentraliseerd en naar beneden gericht. Er werd meer aandacht besteed aan het vermogen van het bedrijf om haar prestaties te kunnen controleren. De communicatie met de vakbonden en de werknemers werd geïntensiveerd. Er werden maar weinig hindernissen tijdens de verandering waargenomen, voornamelijk door managers uit het middenkader die vreesden voor hun baan. Maar een relatief slechte organisatiestructuur en een laag niveau van vaardigheden vertraagden de verandering en verhinderden het bedrijf bij het doorvoeren van alle mogelijke kostenbesparingen.

De aanzet tot de derde veranderingscyclus, welke de vorm aannam van strategische herstructurering, werd duidelijk beïnvloed door de aanname van veranderingen in de sector en de beschikbaarheid van bronnen. Echter, na een korte aanvangsperiode werd de herstructurering onduidelijk en ging het patroon van veranderingen lijken op zwak aaneengesloten verandering die langzaam degradeerde tot niet-aaneengesloten verandering. De strategie zwenkte van regionale diversificatie naar strategisch partnerschap, zonder helderheid in de redenering en zonder een overtuigend actieplan. De directeur kreeg geen steun voor verandering uit de onderlaag.

Daardoor zag de eigenaar zich genooddaakt om de directeur te ontslaan en opnieuw een poging te wagen tot herstructurering. Het nieuwe team bracht een meer gerichte visie naar voren, gebruikte consultants, en bracht buitenlandse managers en vergelijkend onderzoek in

als leerbronnen en aanstuurders van een nieuwe cultuur, reorganiseerde het bedrijf in business units en maakte flink gebruik van IT om de prestaties te optimaliseren en te controleren. Lura richtte zich op klantenbinding, ontwikkeling van nieuwe producten en marketing als strategisch onderscheidende factoren, evenals procesverbetering om zo een betere kostenpositie te bewerkstelligen. De toewijding van het middenkader werd verzekerd door een flinke druk op het behalen van hoge prestaties, door middel van werken aan projecten en het gezamenlijk ontwikkelen van een strategie, maar ook door middel van door de directeur geïnitieerde directe communicatie.

Verzet tegen de verandering was hoofdzakelijk afkomstig van managers uit het middenkader die zich bedreigd voelden en onvoldoende opgewassen tegen de aanpassingen. Het gebrek aan de benodigde vaardigheden en kennis, alsmede problemen in het veilig stellen van de toestroom aan managementtalent, kunnen worden beschouwd als de volgende belangrijke hindernissen bij verandering. Er was enige veranderingsmoeheid merkbaar, deze werd verhevigd door het wisseltekort bij het middenkader, hetgeen een grote druk voor een kleine groep bestaande leiders met zich meebracht, waardoor ze dun werden uitgesmeerd over een aantal veranderinginitiatieven, hetgeen de positieve effecten van het overigens hoge niveau aan organisatorische leerprocessen in de laatste veranderingsfase dreigde te verminderen.

#### 8.5.7 Podravka

Er zijn vier veranderingscycli aan te wijzen in Podravka. Gedurende de eerste cyclus waren er of geen veranderingen of incidentele niet-aaneengesloten aanpassingen, zoals het begin van de niet-systematische verkoopexpansie in Centraal- en Oost-Europa. Het lijkt erop dat institutionele druk en het gebrek aan betrouwbare leiders de belangrijkste factoren zijn bij het ontbreken van prikkels. Duidelijk was ook het gebrek aan prestatietransparantie. Echter, zodra het duidelijk werd dat de onderneming financieel niet levensvatbaar was, zorgden de eigenaren ervoor dat de tweede fase werd ingezet.

De late reactie op de razendsnelle veranderingen in de omgeving brachten het bedrijf niet alleen op de rand van de afgrond, maar creëerden ook de typische gedragspatronen van “verliezers”, inclusief frustratie, een mix van ontkenning en hulpeloosheid, het de schuld geven aan anderen en onethisch gedrag. Omdat er geen intern veranderingstoezicht was, werden er externe consultants ingeschakeld om de veranderingen te begeleiden.

Als gevolg van directe druk van de eigenaren werd er gestart met defensieve herstructurering. Het herstructureren van de bedrijfsmiddelen leek meer effectief dan aanvankelijk verwacht, maar dat lag aan het feit dat dit in het geval van Podravka een methode voorstelde om de werkgelegenheid te verlagen in plaats van financieel te profiteren van het afstoten van bedrijfsmiddelen. Bijna alle adviezen die door de consultants op basis van hun globale optiek werden verstrekt, werden met argwaan begroet. Bijna alle bronnen bevestigen dat alles wat zich niet aanpaste aan locale gewoonten, “de manier waarop wij dingen doen”, werd behandeld als iets wat tegen de interesses van de locale gemeenschap indruiste, ongeacht of het op waarheid berustte. Dit zorgde voor hevig verzet en belemmerde voorgestelde veranderingen op het moment dat de consultants deze aan de directie ter uitvoering overhandigden.

De aanzet voor de volgende twee veranderingscycli was hetzelfde: de slechte financiële situatie van de onderneming en het oordeel van de eigenaren dat verandering noodzakelijk was en mogelijk onder nieuw leiderschap. In de derde veranderingscyclus leek dit meer op niet-aaneengesloten verandering in plaats van defensieve of strategische herstructurering.



Alhoewel de eigenaren in eerste instantie het voortouw namen, lijkt het erop dat de aanname van de noodzaak tot verandering te lijden had van uiteenlopende interesses in de top van het managementkader. Bijzonder lastig was de wijze waarop het bedrijf haar schaarse financiële bronnen aansprak bij het upgraden van haar productiecapaciteit.

De tegenvallende resultaten van de derde veranderingscyclus vroegen om een nieuwe wijziging in de top. De nieuwe voorzitter van de raad van bestuur maakte de strategische doelpositie van het bedrijf duidelijk: toegevoegde waarde op basis van hoge kwaliteit, locale smaak, een sterk merk en een uitstekende distributie. Hij reorganiseerde de onderneming in de zakelijke lijnen en introduceerde de benodigde ondersteunende infrastructurele eenheden. Het bedrijf schakelde ook over op een globale koers. Echter, omdat het bedrijf zuchtte onder een schuldenlast, moest het eerst haar operationele prestaties verbeteren alvorens er ruimte was voor significante investeringen in kritieke onderdelen. Dit vormde een andere reden waarom het tijdsbestek voor verandering uitermate belangrijk werd.

De nieuwe voorzitter, een buitenstaander met een uitstekende beroepsreputatie, hoopte te kunnen rekenen op het initiële vertrouwensniveau dat nodig was om de veranderingen door te voeren. Echter, gelet op het bijzonder gesloten karakter van de locale omgeving en het hoge niveau van aangenomen dreiging dat hij voorstelde, moest hij aanvankelijk een aantal compromissen sluiten, de rechtmatige positie van de gemeenschap accepteren en haar vertrouwen winnen door de bedrijfsresultaten te verbeteren, zonder daarbij maatregelen te nemen die schadelijk zouden kunnen zijn voor de locale interesses.

Terwijl het in de derde cyclus leek alsof strategische onzekerheid een te overwinnen hindernis was, was dit geenszins zo in de laatste fase, waarschijnlijk vanwege de aanwezigheid van een duidelijke visie. Andere hindernissen, met name de diverse angstvormen, slechte structuren en (in het bijzonder) gebrek aan vaardigheden en kennis, waren allen duidelijk waarneembaar.

## 8.6 Kruisanalyse en integratie van de onderzoeksbevindingen

Alle zeven casussen vertonen een aanzienlijke hoeveelheid veranderingen bij de waargenomen ondernemingen, alsmede diverse onderscheidende periodes (cycli) van verandering (Tabel 8.1).

| Casus                | Periode 1           | Periode 2           | Periode 3           | Periode 4   |
|----------------------|---------------------|---------------------|---------------------|-------------|
| Gorenje              | Defensief           | Strategisch         | Strategisch         | Strategisch |
| Kolinska             | Defensief           | Niet-aaneengesloten |                     |             |
| Končar               | Defensief           | Niet-aaneengesloten | Strategisch         |             |
| Lek                  | Defensief           | Strategisch         | Niet-aaneengesloten | Strategisch |
| Ljubljanske mlekarne | Niet-aaneengesloten | Niet-aaneengesloten | Defensief           | Strategisch |
| Lura                 | Geen verandering    | Defensief           | Strategisch         | Strategisch |
| Podravka             | Geen verandering    | Defensief           | Niet-aaneengesloten | Strategisch |

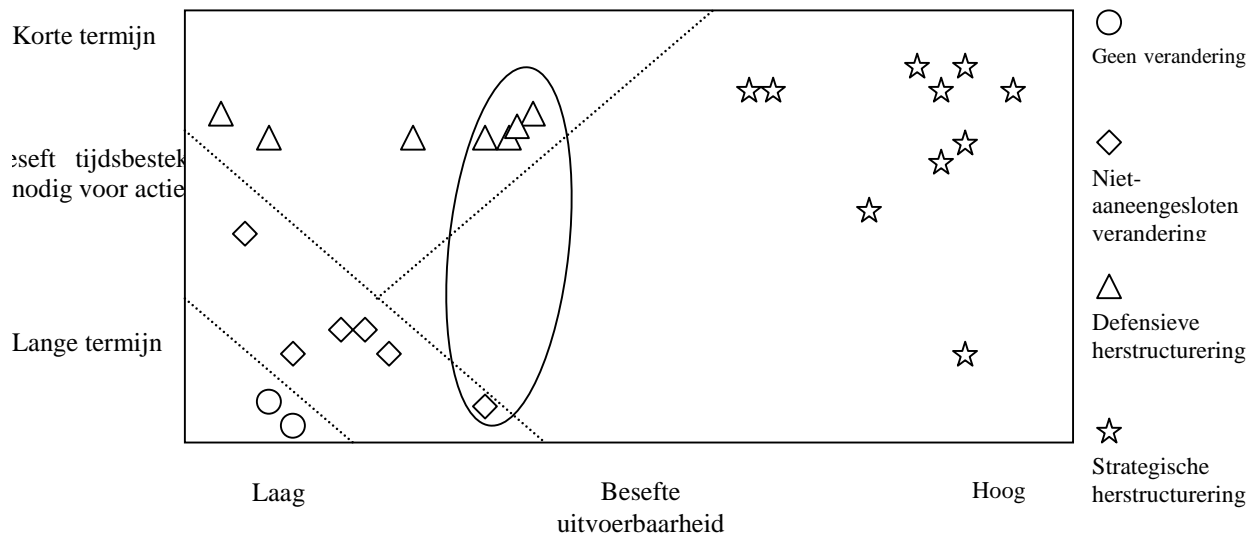
Tabel 8.1 Aard der veranderingen in zeven waargenomen casussen

De onderstaande punten vertegenwoordigen de hoofdconclusies van de kruisanalyse:

- Strategische verandering in een onderneming begint met het besef van het bestuur dat verandering urgent is, of gemakkelijk uitvoerbaar of beide. De aanzetfase kan langere tijd in beslag nemen en inzichten worden cumulatief geformuleerd.
- Het besef van de noodzaak is gebaseerd op interpretatie van de context en wordt voornamelijk aangestuurd door:
  - Institutionele druk;
  - De waargenomen financiële situatie, gelet op de prestatietransparantie;
  - Groeimogelijkheden;
  - Het bestuur.
- Het besef van uitvoerbaarheid is gebaseerd op interpretatie van de context en wordt voornamelijk aangestuurd door:
  - Institutionele druk;
  - Veranderingen binnen de sector en de markt;
  - Beschikbaarheid van bronnen (inclusief vaardigheden);
  - Het bestuur.
- Zodra de verandering ingezet is, start het bestuur met het opzetten van een nieuwe organisatiestructuur. De overgang van de aanzetfase naar de opzetfase is redelijk abrupt.
- Afhankelijk van de besepte urgentie en de uitvoerbaarheid van verandering (zie Fig. 7.2), kiest het bestuur voor de volgende opzetmogelijkheden:
  - Geen verandering;
  - Een aantal veranderingen die niet duidelijk aaneengesloten zijn;
  - Defensieve herstructurering;
  - Strategische herstructurering.
- Defensieve en strategische herstructurering zijn als optie superieur aan niet-aaneengesloten verandering.
- De voornaamste eigenschappen van defensieve herstructurering zijn:
  - Organisatiestructuur
    - Herstructurering van de bedrijfsmiddelen gebruikt als middel tot inkrimping
    - Focus op inkrimping, zacht inkrimpen geeft betere resultaten dan hard
    - Focus op diverse vormen van kostenbesparing
    - Centralisatie
    - Reorganisatie t.b.v. een betere prestatietransparantie en de focus op de kernactiviteiten
    - Geen significante veranderingen in het businessmodel van de kernactiviteiten
  - Voornaamste bronnen
    - Beschikbare financiële bronnen worden gebruikt voor herstructurering
    - Efficiënt controlesysteem
    - Basisbekwaamheid noodzakelijk in het bestaande businessmodel, inclusief bekwame werknemers.
    - Vertrouwen in de directeur en de overlevingskansen van het bedrijf
  - Bestuurlijke interventies
    - Topdown besluitvorming
    - Intensieve communicatie met de belangrijke belanghebbenden, met name de werknemers, met het doel vertrouwen op te bouwen

- Gebruik van dwang om uitvoering te versnellen en de introductie van procesdiscipline
  - Het inzetten van externe consultants om zeker te zijn van kostenbesparingen en procesverbeteringen
- Te overwinnen hindernissen
  - Laag niveau van kennis, vaardigheden en een negatieve houding, met name diegene die geassocieerd worden met marktgerelateerde vaardigheden en het tonen van initiatieven
  - Angst, in het bijzonder m.b.t. incompetentie en ontslag, te zien bij het middenkader
  - Strakke werknemershiërarchie
  - Uitermate beperkte organisatorische leerprocessen, alsmede onvoldoende bronnen voor investering in het uitbouwen van vaardigheden
- De voornaamste eigenschappen van strategische herstructurering zijn:
  - Organisatiestructuur
    - Heldere omschrijving van de strategische positie en de bronnen van voordelen m.b.t. concurrentie
    - Focus op het uitbouwen van de essentiële vaardigheden
    - Organisatorische leerprocessen aan de hand van globale bronnen
    - (Het juiste niveau van) Decentralisatie
  - Voornaamste bronnen
    - De financiële bronnen worden gebruikt voor herstructurering, met name het uitbouwen van vaardigheden
    - Focus op marktvaardigheden en klantenbinding
    - Vertrouwen in de directeur
    - Flexibele reactie op veranderingen, met name ontwikkeling van nieuwe producten
    - Vermijden van opportunistisch gedrag
    - Actief relatiemanagement t.o.v. de belanghebbenden
    - Aanzienlijke hoeveelheid tijd beschikbaar voor herstructurering
  - Bestuurlijke interventies
    - Topdown besluitvorming
    - Topdown communicatie gericht op strategische positionering en het bouwen van vertrouwen
    - Inzetten van externe consultants en formele verbeteringsprojecten om de veranderingen te ondersteunen
    - Uitoefenen van druk op de prestaties van het middenkader en verandering van hun werkwijze
    - Toewijding aan de cultuurverandering, in het bijzonder het meer internationaal denken en het tonen van initiatieven
  - Te overwinnen hindernissen
    - Gebrek aan competent en initiatiefrijk middenkader
    - Middenkader vertoont angst om hun baan te verliezen
- De implementatie van de nieuwe organisatiestructuur kan al van start gaan voordat haar opzet is voltooid;
- Strategische herstructurering duurt gemiddeld langer dan defensieve herstructurering en kan verscheidene jaren in beslag nemen;
- Het succes van de implementatie hangt af van de consistentie van de opzet alsmede de bronnen en de bestuurlijke interventies, die aansluiten op de gekozen opzet.

Een belangrijke opmerking is gewijd aan de duidelijkheid van de positionering in de diagrammen die besepte urgentie en uitvoerbaarheid van verandering koppelen aan het gekozen herstructureringsmodel. Zoals al eerder opgemerkt, werden de waarden voor de variabelenparen niet vastgesteld door exacte metingen. Een vergelijkbare losse methodiek werd toegepast bij het bepalen van de grenzen van regio's met de zelfde veranderingskenmerken. Desalniettemin lijken de resulterende groeperingen consistent, zoals weergegeven in Figuur 8.3 en worden zij stevig ondersteund door de waarnemingen uit het veldonderzoek.



Figuur 8.3 Afbeelding van de waargenomen aanzetwaarden van de veranderingscyclus en de resulterende opzetkenmerken

Zoals hierboven aangegeven, duiden de veranderingscycli dicht bij de regiogrens (omcirkeld in Figuur 8.3) op geleidelijke in plaats van plotselinge overgangen tussen de regio's. Alhoewel voor alle cycli geldt dat de regio bepalend is voor de belangrijkste kenmerken van de veranderingscyclus, zijn er ook een aantal kenmerken van naburige regio's vertegenwoordigd. Dit impliceert een ander tegen de intuïtie ingaand fenomeen dat waargenomen werd tijdens het veldonderzoek: sommige veranderingscycli bezaten de dominante kenmerken van defensieve herstructurering met een aantal sporen van strategische herstructurering en andersom.

Nogmaals, de nadruk dient te worden gelegd op het feit dat de hierboven getoonde positionering een weerspiegeling vormt van de opzetkeuze en niet noodzakelijkerwijs het succes of het falen van de gepoogde verandering impliceert. Beter gezegd, de veranderingsuitkomsten werden gekoppeld aan de gekozen organisatiestructuur, beschikbare bronnen, bestuurlijke interventies en te overwinnen hindernissen.

## 8.7 Conclusies

Parallel met de bevindingen van de kruisanalyse, direct gerelateerd aan de verfijning van het onderzoeksmodel zoals te zien in 8.6, biedt het onderzoek diverse relevante inzichten voor de managementtheorie en de praktijk.

Ten eerste draagt het onderzoek bij aan het begrijpen van strategische verandering als integraal verschijnsel. Terwijl de bestaande literatuur zelden strategische verandering op deze wijze benadert, toont het onderzoek duidelijk aan dat er geen echt begrijpen mogelijk is zonder een koppeling van context, inhoud en proces. Het onderzoek treedt buiten het relatief algemene concept van context, inhoud en proces als bouwstenen van strategische verandering, in de richting van het structureren van de afzonderlijke elementen die deze bouwstenen omzetten naar meer operationele termen. Zo wordt het context-inhoud-proces-model vertaald naar een aanzet-opzet-implementatie-model.

Het is van belang om op te merken dat het nieuwe model niet alleen de mechanismen verklaart waarmee context, inhoud en proces de managementrealiteit beïnvloeden, maar ook de tijdsvolgorde introduceert in fasen van strategische verandering. In tegenstelling tot de voorgaande integrale modellen biedt deze constructie zowel simpele als gedetailleerde uitleg.

De volgende inbreng van het onderzoek is dat het de besepte noodzaak en uitvoerbaarheid van verandering op de voorgrond plaats in de beschouwing van de eerste veranderingsfasen. Deze twee factoren zijn niet alleen direct gekoppeld aan het eigenlijke beginpunt van verandering, maar ook aan de veranderingsdoelen. Het onderzoek koppelt tevens de twee factoren aan een beperkt aantal elementen in de externe en interne context, die een doorslaggevende invloed hebben op de wijze waarop het management deze twee sleuteldeterminanten opmerkt.

Een volgende bijdrage van het onderzoek is de notie dat veranderingsdoelen efficiënt kunnen worden beschreven middels de nieuwe organisatiestructuur, via haar definities van strategie, organisationele opbouw en organisatiesystemen. Het onderzoek omschrijft verder de vier voornaamste uitkomsten van de opzetfase als (a) de beslissing om geen grote veranderingen in de organisatiestructuur door te voeren, (b) de beslissing om het te veranderen zonder een duidelijk coherent patroon, (c) de beslissing om het te veranderen op een wijze die overeenkomt met defensieve herstructurering en (d) de beslissing om het te veranderen op een manier die correspondeert met strategische herstructurering. Zoals hierboven opgemerkt, wordt de gekozen optie beïnvloed door de besepte noodzaak en de uitvoerbaarheid van verandering.

Het is van belang om op te merken dat het onderzoek ook een theoretisch dilemma in het ontwerp van een strategie beantwoordt: moet de onderneming uitgaan van een van buiten naar binnen-optiek (wat de redenering zou zijn van, laten we zeggen, de omgevingsstroming) of een van binnen naar buiten-optiek (volgens de bronstroming)? Het antwoord luidt: beide, omdat een optiek niet alle antwoorden biedt die nodig zijn voor een solide opzet van de nieuwe organisatiestructuur.

Het onderzoek draagt verder bij door het duidelijk omschrijven van de belangrijkste te overwinnen hindernissen die verwacht mogen worden bij defensieve of strategische herstructurering. Het is vooral interessant om op te merken dat het onderzoek concludeert dat er maar relatief weinig knelpunten zijn, in tegenspraak met de gangbare ideeën op dit terrein.

Tenslotte levert het onderzoek een cruciale bijdrage door het koppelen van het succes van de implementatie van verandering aan de interne consistentie van de organisatiestructuur, de beschikbaarheid van bepaalde doorslaggevende bronnen en het bestaan van bestuurlijke interventies. Deze bijdrage is in het bijzonder belangrijk sinds een van de grootste misvattingen van de brongerichte optiek, en de voornaamste reden voor haar gebrek aan populariteit onder praktiserende managers, is haar onvermogen om helder de vitale bronnen

voor het succes van een onderneming in een bepaalde context te kunnen formuleren en hoe ze te creëren. Dit onderzoek toont aan dat, alhoewel essentiële bronnen en bestuurlijke interventies van elkaar verschillen in defensieve en strategische herstructurering, beide van de laatste duidelijk kunnen worden omschreven en beide (a) vertrouwen op een centrale positie als de levensbron voor verandering en (b) vertrouwensbouwende interventies als de primaire taak van interim-managers zien.

Wat betreft de consequenties voor de praktiserende managers dient men te beginnen door te kijken naar de eigenlijke aard van de verandering. Veel filosofen en schrijvers, inclusief diegenen actief op het gebied van handel en management, beweren dat verandering de enige constante in het leven is (zowel menselijk als zakelijk als). Verandering genereert voortdurend een veelheid aan uitdagingen voor managers. Wat moet er gedaan worden om de onderneming voor te bereiden op de volgende veranderingsronde? Wat is het juiste tijdstip om de verandering te starten? Wat dient haar reikwijdte en schaal te zijn? Wat moet het doel van verandering zijn? Welke hindernissen mogen we verwachten? Zodra we verandering op gang brengen, wat moeten doen om het daadwerkelijk te laten gebeuren?

Als er iets kan worden gezegd, is het dat dit onderzoek getuigt van het belang van verandering in het leven van de geobserveerde ondernemingen. Alhoewel de verandering niet altijd dezelfde intensiteit had, werden er geen belangrijke doelen zonder een significante hoeveelheid ervan bereikt, en de bedrijven moesten er in meegaan, zodra de doelen waren uitgestippeld. Dit is de eerste belangrijke boodschap voor managers: **vertrouw er niet op dat een gekozen strategie in de praktijk kan worden gebracht zonder te accepteren dat je met veranderingen te maken krijgt.**

Wetende – of zoals veel ervaren managers meer van toepassing vinden – aanvoelen van het juiste moment om te beginnen met strategische verandering is niet noodzakelijkerwijs een vaardigheid die van nature in de wereld van het managersvak voorkomt. Alhoewel ervaring en gevoel op prijs worden gesteld, dienen managers ook de noodzaak tot systematisch observeren van de context waarbinnen zij werkzaam zijn te accepteren. In het bijzonder dienen zij zich af te vragen; **voldoet de organisatiestructuur (strategie, opbouw en systemen) aan de eisen van de context?** Zo niet, dan mogen ze verwachten dat de onderneming op zijn best geleidelijk of abrupt – in een turbulent worst-case contextscenario – haar handhaafbare concurrentievoordelen zal verliezen.

De hedendaagse managementwetenschap biedt diverse strategische hulpmiddelen die managers bij een strategische analyse kunnen gebruiken, een veelheid daarvan wordt door consultants aangeboden. Sommige zijn populair en wijd verbreid, anderen worden door een selecte groep gebruikt. Sommige claimen eenvoudigheid, terwijl anderen hun aantrekkingskracht koppelen aan complexiteit. Een goed voorbeeld is de invloed van de positioneringsbenadering op de strategie. Veel managers in de geobserveerde bedrijven gebruikten de krachtige eenvoud van het “Hoge Besepte Waarde versus Lage Afleveringskosten” paradigma om hun strategische doelen te definiëren.

Zonder twijfel heeft dat geholpen. Ze konden gemakkelijk hun ideeën aan hun collega's en werknemers uitleggen, en de beoogde strategische positie als motivator gebruiken. Echter, door deze route te nemen liepen ze vroeger of later tegen een belangrijke hindernis aan: alhoewel het makkelijk was om de gewenste strategische positie te omschrijven en te communiceren, was het minder gemakkelijk om te ontdekken en anderen ervan te overtuigen hoe de betreffende positie vertaald kon worden naar de intern in het bedrijf aanwezig

vaardigheden. Soms kwamen managers er zelfs achter dat de beoogde positie niet veel meer was dan een droom, omdat de vaardigheidskloof eenvoudigweg te groot was.

Daarom doen managers er goed aan om een **van binnen naar buiten-optiek (uitgaande van interne vaardigheden) te combineren met een van buiten naar binnen-optiek (aangegeven door de strategische positie)**. Ongeacht de moeilijkheid van het verkrijgen van een helder en objectief van binnen naar buiten perspectief, zonder bestaat er geen hoop op het vastleggen van voldoende duidelijke veranderingsdoelen.

Het hierboven beschreven standpunt heeft een belangrijk gevolg: **managers dienen ondernemingen voor te bereiden op verandering**. Er kunnen op dit gebied een aantal algemene stappen worden ondernomen. Ten eerste, managers dienen te werken aan het creëren van mechanismen die een regulier strategisch analyseproces ondersteunen. Ze dienen zowel de externe dimensie en het begrijpen er bij te betrekken, een expliciete definitie en communicatie van de bestaande basisvaardigheden, inclusief de bedrijfscultuur. Ze dienen ook een veranderingsinfrastructuur te bouwen, in het bijzonder het vermogen tot vertrouwen en communicatie met de voornaamste belanghebbenden. Tot slot dienen ze te werken aan het verstevigen van het middenkader, dat, zoals hieronder besproken, meestal het voornaamste knelpunt bij verandering vormt. Correcte HR-procedures moeten worden ingevoerd, en het middenkader dient zich tot het uiterste in te spannen om kennis, vaardigheden en gedrag verder te ontwikkelen.

Een belangrijk deel van de verantwoordelijkheid voor het tijdig initiëren van de verandering ligt bij de bedrijfsbesturingsmechanismen, met name raden van toezicht. Strategisch risicomanagement dient in ieder geval een van hun hoofdtaken te zijn, en het is eenvoudig in te zien dat een trage start bij noodzakelijke strategische veranderingen de kans op strategische risico's ernstig vergroot. Bestuurders dienen zich te realiseren dat **het begin van strategische verandering vaak gerelateerd is aan verandering in de top van de onderneming**. Als de topmanager weigert de noodzaak van verandering – die voor anderen duidelijk zichtbaar is – in te zien, betrokken raakt bij een reeks van niet-aaneengesloten veranderingen of kiest voor verlengde defensieve herstructurering, dan loont het om een eenvoudige vraag te stellen: is deze persoon geschikt als interim-bestuurder? Vaak is het niet een wijziging in externe omstandigheden die de aanzet vormt voor significante strategische verandering, maar een frisse kijk van boven die voorheen ongeziene kansen blootlegt en die in de benodigde dosis gerichte energie voorziet.

Er is een paradox gerelateerd aan het initiëren van verandering die het leven van een manager lastig maakt: alhoewel het makkelijker is om te beginnen met verandering in crisistijd, is dit ook de periode waarin er minder bronnen beschikbaar zijn en elke fout kostbaarder wordt. **Daarom moeten managers niet wachten met het initiëren van strategische verandering tot er een crisis uitbreekt**. Ze moeten een manier vinden om een gevoel te creëren van beseft noodzaak tot verandering, op zijn minst in de mate die nodig is om hun directe gevolg in beweging te krijgen. Dit biedt hun de gelegenheid om positief gebruik te maken van financiële overschotten en andere bronnen, die normaliter worden beschouwd als vertragers van verandering.

Aan de andere kant, wanneer managers een urgente noodzaak tot verandering opmerken die niet in overeenstemming is met de juiste bronnen, is verlamming niet het antwoord. **Een absolute noodzaak tot verandering, zelfs als deze onuitvoerbaar lijkt, vraagt om defensieve herstructurering**. Mits op juiste wijze ondernomen, leidt defensieve

herstructurering tot een snelle verbetering van de financiële situatie en kan dienen als een goed uitgangspunt voor strategische herstructurering.

Het blijven hangen in de defensieve herstructureringsfase gedurende een lange periode (alhoewel er geen strikte regels zijn, mogen de meeste defensieve herstructureringsprocessen in principe niet langer dan een jaar duren) of het terugkeren naar een situatie zonder verandering of niet-aaneengesloten veranderingen is gevaarlijk. **Defensieve herstructurering vormt slechts de helft van het karwei en dient onmiddellijk te worden gevolgd door strategische herstructurering.** Zo niet, is de kans op het opnieuw optreden van de neerwaartse spiraal groot en zal elke volgende ronde van defensief herstructureren moeilijker blijken.

Managers dienen te begrijpen dat **defensieve en strategische herstructurering vragen om een significant andere organisatiestructuur, essentiële bronnen en bestuurlijke interventies.** Bijgevolg, de overgang van defensieve naar strategische herstructurering is lastig en vereist volledige aandacht van het management, alsmede gerichte inzet. Drie zaken verdienen extra aandacht: organisatorische leerprocessen, decentralisatie en tijd. Organisatorische leerprocessen zijn afwezig tijdens defensieve herstructurering, terwijl deze de sleutel vormt tot strategische herstructurering, gedurende welke een mondiaal perspectief, klantenbinding en ontwikkeling van nieuwe producten kenmerkende voorwaarden zijn. Het verschuiven van de aandacht van strikte implementatie en oriëntering op kosten naar innovatie en leerprocessen is geen gemakkelijke opgave. Het vereist een cultuurverandering, welke niet kan worden bereikt zonder een sterke betrokkenheid van het middenkader. Decentralisatie is nodig om deze toewijding te bewerkstelligen, evenals tijd nodig is voor de noodzakelijke uitbouw van vaardigheden en de cultuurverandering zelf.

Alhoewel het merendeel van de aan strategisch veranderingsmanagement gerelateerde literatuur de nadruk legt op visie als het sleutelbegrip in strategische herstructurering, moet men de slaaf worden van een potentieel lege frase. **Managers moeten niet wachten op het “grote visioen” wanneer ze een begin maken met strategische verandering.** Visie kan effectief worden vervangen door vertrouwen, dat er voor zorgt dat de leider zijn volgers aan boord houdt zelfs als hij door wilde golven in de context vaart. Dit betekent ook dat strategische onzekerheid niet als een blokkade dient te worden beschouwd en als een excuus om strategische verandering uit te stellen. Echter, het ontbreken van visie kan entropie veroorzaken, aangezien het dient als een kader en filter voor strategische initiatieven. Daarom dienen bestuurders een kader te scheppen, zelfs indien zij dit niet formeel als een visie poneren. Een methode om dit voor elkaar te krijgen is middels een duidelijke organisatiestructuur en een focus op de overige elementen van het 7S-kader. De consistentie van 7S is waarschijnlijk de beste test of een visie in de praktijk bestaat en hoe effectief deze vertaald wordt naar managementacties. Groei dient binnen dit kader een van de hoofddoelen te vormen binnen.

Externe consultants en diverse verbeteringsprojecten kunnen helpen bij het wijzigen van de bedrijfskoers. Echter, managers dienen te letten op **de neiging van consultants om tactische projecten op te zetten, die zich bezig houden met efficiency in plaats van het creëren van waarde.** Een citaat van Dr. Peter Kraljič from McKinsey & Co.: “Dit is niet verrassend aangezien consultants geen ondernemers zijn en strategische herstructurering nauw geassocieerd wordt met het nemen van risico's. Daarnaast zijn de resultaten van efficiencygerichte projecten veel beter te voorspellen en sneller zichtbaar, beide favoriete punten in de gemiddelde consultancyovereenkomst.”



Alhoewel strategische herstructurering bouwt op vertrouwen en consistentie, welke op hun beurt een hoge betrokkenheid van het middenkader vragen, dienen managers er op te letten dat **de kans zeer groot is dat een belangrijk percentage van het middenkader niet door de strategische verandering heen komt**. Het aantal uitvallers zal echter lager zijn wanneer managers uit het middenkader zorgvuldig worden voorbereid op hun nieuwe uitdagingen, zowel op het gebied van opleiding gericht op het ontwikkelen van de juiste vaardigheden, als organisatiesystemen die hun nieuwe rol in de onderneming versterken. Desalniettemin blijft het middenkader de grootste te overwinnen hindernis, het vertoont vaak een verdedigende houding en veel angst (voor mogelijke incompetentie en ontslag). Daarom hebben ze hulp nodig, en dienen ze duidelijke, aan het veranderingsdoel gerelateerde opdrachten te krijgen, die aan de hand van overzichtelijke criteria moeten worden uitgevoerd binnen een redelijk kort tijdsbestek of geconfronteerd te worden met vervanging. Transparantie in beloning en loopbaanbesluiten, alsmede gezichtsverliesbeperkende ontsnappingsmogelijkheden in het geval van onacceptabele prestaties, is evident en verbetert op aanzienlijke wijze het vertrouwensniveau in een organisatie.

De management top draagt de ultieme verantwoordelijkheid voor het resultaat van de strategische verandering. Deze regel vraagt veel, en de last ervan moet door alle leden worden gedeeld. Alhoewel onderlinge bedrijfsculturen verschillen, **is het verstandig om consensus als besluitvormingsinstrument te gebruiken bij alle aan strategische verandering gerelateerde kwesties, met name strategische herstructurering**. Als een kleine groep in de top niet tot eenstemmigheid komt, zijn de kansen op een succesvolle en snelle implementatie aanzienlijk kleiner en loont het om op zoek te gaan naar een consensusbouwend alternatief.

Tot slot, **strategische herstructurering is een lang proces**. Het duurt al snel een decennium voordat een onderneming het beoogde handhaafbare concurrentievermogen bereikt. Dit betekent dat managers zich moeten voorbereiden op langdurige aanslagen op hun energieniveau, zonder daarbij in te boeten aan gedrevenheid en consistentie, en zonder grote fouten in de opzet en implementatie te maken. Alleen de steun van de voornaamste belanghebbenden kan verandering vergemakkelijken, het managen van de verwachtingen scherp houden en intensieve communicatie van onschatbare waarde maken. Managers dienen daarnaast niet te vergeten dat het onderweg maken van winst bijdraagt aan vertrouwen en rust. Daarom: **het managen van vandaag is net zo belangrijk bij strategische verandering als het managen van de dag van morgen**.

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